

# Office Market Report

Tokyo | Q1 2017

May 2, 2017



## Summary

- In the March 2017 quarter, the Tokyo 23 Wards' office market continued to see a decrease in vacancy rate and an increase in contract rent. The market looks tight with the vacancy rate at the 3% level but the rental growth remained slow.
- The **vacancy rate** was 3.76%, a decrease by 0.09 points. **Increase and Decrease in Vacant Space** showed that the vacant space decreased by 276,000 tsubo and increased by 258,000 tsubo; the decrease surpassed the increase. **Vacancy Turnover Ratio**, which is the ratio of vacant space leased during the quarter to all the vacancy stock, is on the rise.
- **New Contract Rent Index** (the level of new lease rent) was 108, an increase by 1 point. **Contract Rent Diffusion Index**, calculated by subtracting the percentage of buildings with a rent decrease from the percentage of buildings with a rent increase, was +6. Although the DI remained in the positive area, the decrease by 12 points was relatively large; we will pay close attention to what happens next.
- **Paying Rent Index** (the level of new lease rent and the level of existing lease rent combined) was 88, an increase by 2 points.
- **Average Free Rent Month** was 2.6 months, a decrease by 0.2 months. **Ratio of Free Rent Granted** also decreased for leases with two months or more free rent and those with six months or more free rent.

### Office Market Report | Tokyo | Q1 2017

All the contents are as of the date of this report. Xymax Corporation does not guarantee the accuracy or completeness of the information herein. Copying, quoting, forwarding, distributing, reprinting or any other use of this report is not allowed without prior permission from Xymax Real Estate Institute Corporation.

Copyright © 2017 Xymax Corporation. All rights reserved.

Figure 1: Vacancy Rate



## Vacancy

Figure 1 shows changes in vacancy rate in Tokyo 23 Wards since 2011. The vacancy rate in the first quarter of 2017 decreased by 0.09 points quarter-on-quarter to 3.76%. The rate kept decreasing since the third quarter of 2012.

The vacancy rate is at the 3% level; the market looks even tighter than before. Many companies are willing to expand their office to accommodate new employees, and such companies often take the new vacant space in their current buildings. The central part of Tokyo is having a limited availability that meets the requirements of tenants; demand for office has spread into the periphery 18 wards.

Figure 2: Increase and Decrease in Vacant Space

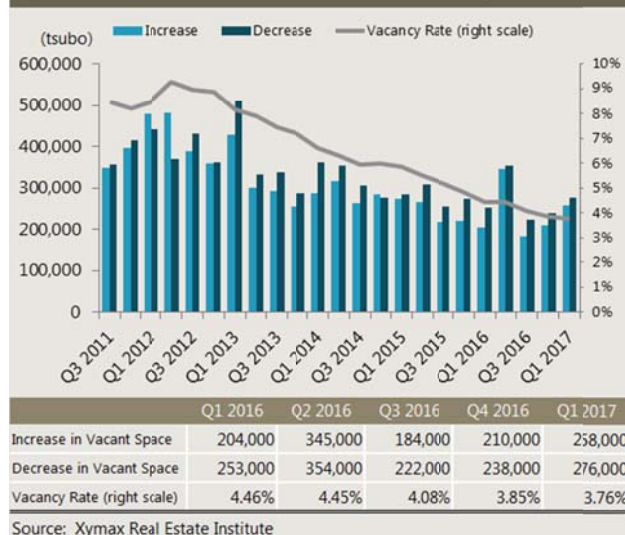


Figure 2 shows a quarterly increase and a quarterly decrease in vacant space (**Increase and Decrease in Vacant Space**). The demand for office space was strong; although 258,000 tsubo of new vacant space, the amount greater than that in previous quarter by nearly 50,000 tsubo, was added this quarter following the completion of new buildings, 276,000 tsubo of vacant space was leased to tenants. The decrease in vacant space exceeded the increase by approximately 20,000 tsubo. The decrease exceeded the increase for nine consecutive quarters since the first quarter of 2015, influencing the continued decrease in the vacancy rate.

Figure 3: Vacancy Turnover Ratio (4-quarter moving average)



Figure 3 shows the **Vacancy Turnover Ratio (4-quarter moving average)**, which is the ratio of vacant spaces leased to tenants during the quarter to all the vacant office stock (initial vacancy + vacancy added during the quarter). If this ratio is high, it means that there are vacant spaces but such spaces are being taken by tenants. If this ratio is low, it means that vacant spaces remain vacant and landlords are struggling to attract tenants.

Figure 3 shows that the ratio is slowly moving upward. This indicates that the available stock is being leased more rapidly little by little.

We will check this ratio on a regular basis to find out how the level changes along the market change.

## Office Market Report | Tokyo | Q1 2017

All the contents are as of the date of this report. Xymax Corporation does not guarantee the accuracy or completeness of the information herein. Copying, quoting, forwarding, distributing, reprinting or any other use of this report is not allowed without prior permission from Xymax Real Estate Institute Corporation.

Copyright © 2017 Xymax Corporation. All rights reserved.

Figure 4: New Contract Rent Index



Figure 5: New Contract Rent Index by Size of Building



Figure 6: Contract Rent DI (Tokyo 23 Wards)



## New Contract Rent

Figure 4 shows changes in **New Contract Rent Index**, which is the index of the new lease rent. The index for the first quarter of 2017 was 108, an increase by 1 point from 107 in the previous quarter. After bottoming in the second quarter of 2012 at 76, the new lease rent continued to increase. The market is tight and new lease rent is increasing; however, the rate of increase in the current quarter was small.

Figure 5 shows changes in the New Contract Rent Index by size of buildings. The index for small and medium buildings (gross floor area: below 5,000 tsubo) was 107 and the index for large buildings (gross floor area: over 5,000 tsubo) was 109; both remained unchanged from the previous quarter.

The owners of large buildings offered high rent for the remaining small vacant space, but it did not influence the contract rent level. The index for small and medium buildings also remained flat but the breakdown shows that the rental growth was relatively large in the periphery 18 wards; indicating that the rent is rising there at a modest rate as demand spread to those areas.

Figures 6 and 7 are changes in the **Contract Rent Diffusion Index (DI)**. They show the direction of the change in new lease rent. The DI in this quarter was +6 for Tokyo 23 Wards, a decrease by 12 points, and +5 for the central three wards, a decrease by 10 points. The DI remained positive for eight consecutive quarters, meaning the buildings with a rent increase continued to exceed the buildings with a rent decrease.

It is often said that real estate market is lagging behind actual market but the Contract Rent DI actually moves along with other market indicators. It is one of the real estate indicators that can be used as a leading indicator.\*

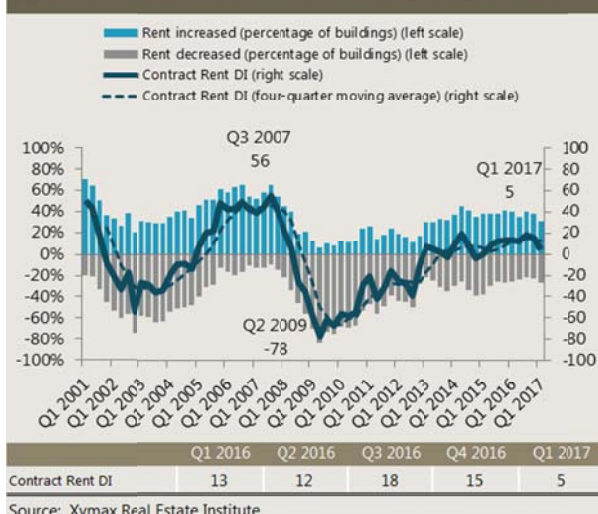
\* Release of Quarterly Contract Rent DI Report released on December 13, 2013

## Office Market Report | Tokyo | Q1 2017

All the contents are as of the date of this report. Xymax Corporation does not guarantee the accuracy or completeness of the information herein. Copying, quoting, forwarding, distributing, reprinting or any other use of this report is not allowed without prior permission from Xymax Real Estate Institute Corporation.

Copyright © 2017 Xymax Corporation. All rights reserved.



**Figure 7: Contract Rent DI (Tokyo Central Three Wards)**


The changes in the Contract Rent DI (Tokyo 23 Wards) show that the decrease of more than 10 points was recorded for the first time since the fourth quarter of 2014 when the DI decreased by 13 points. In that quarter, the DI dropped to the negative area (-2), which means that the buildings with a rent decrease exceeded the buildings with a rent increase. The New Contract Rent Index also decreased in the following quarter (Q1 2015) from 94 to 92.

In the current quarter, the DI is still in the positive area (+6) and the vacancy rate is also low at the 3% level. The current situation is different from the time of the negative DI in the fourth quarter of 2014. We will, however, pay close attention to what happens next since the decrease by 12 points this quarter was relatively a large decrease, and the turning point (zero) is nearing.

## Paying Rent

Figure 8 shows changes in the **Paying Rent Index**, in which new lease rents and existing lease rents are both covered. The index in the first quarter of 2017 was 88, an increase by 2 points. It continued the modest growth since the third quarter of 2013. Not only the increase in rent of new lease but also the increase in rent of existing lease has contributed to the growth of the Paying Rent Index.

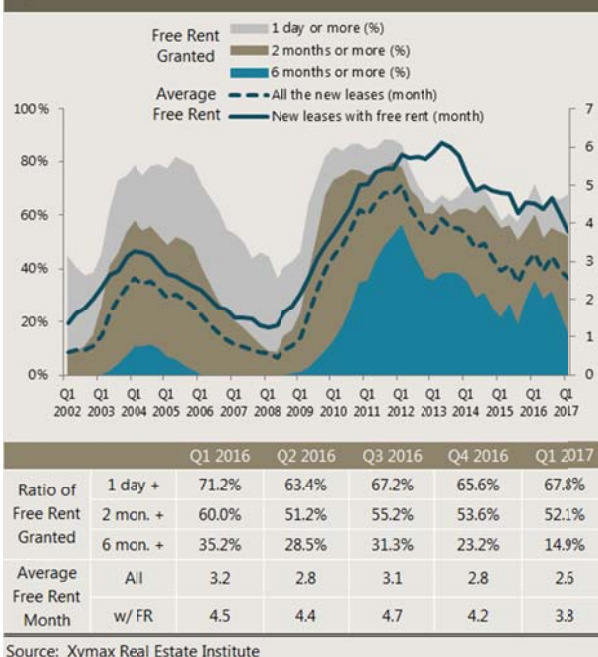
**Figure 8: Paying Rent Index**

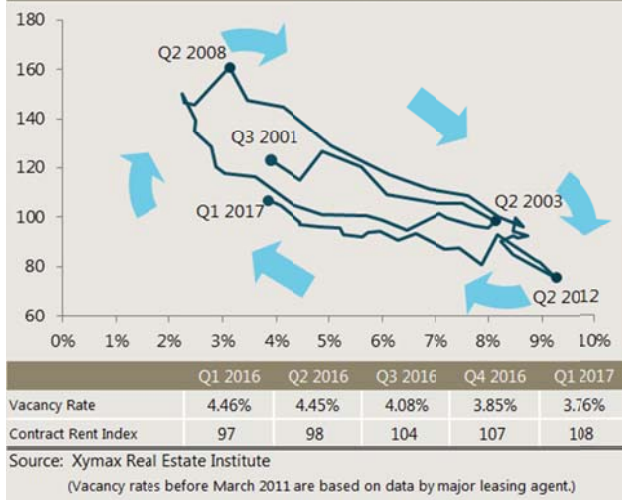

## Free Rent

Figure 9 shows changes in the ratio of new leases with free rent to all the new leases (**Ratio of Free Rent Granted**) and changes in the average free rent period (**Average Free Rent Month**).

The Average Free Rent Month in the first quarter of 2017 was 2.6 months for all the new leases and 3.8 months for leases with free rent; a decrease by 0.2 months and 0.4 months, respectively. The Ratio of Free Rent Granted of two months or more and those of six months or more also decreased.

The shorter free rent period and decrease in the Ratio of Free Rent Granted continued, reflecting the tight market. The decrease in the ratio of six months or more free rent was large in particular.

**Figure 9: Free Rent**


**Figure 10: Market Cycle**

## Market Cycle

Figure 10 is a graph plotted by quarter based on vacancy rates on the horizontal axis and the New Contract Rent Index on the vertical axis.

The graph shows that the market is cyclical; the plot started to move to lower right in 2001 (vacancy up, rent down) and remained static in 2003-2004, then it started to move to upper left in 2005 (vacancy down, rent up) and to lower right again in 2008 (vacancy up, rent down).

The office space market entered the recovery phase in 2013 and remained there in 2017 too. This quarter also saw an increase in new lease rent and a decrease in vacancy rate; the plot moved slightly to the upper left.

## Reference

**Figure 11: Major Building Completions (Q1 2017)**

Name	Floors Above Ground / Below Ground	Ward	Address	Completion	GFA
Sumitomo Fudosan Azabu Juban Building	10 / 0	Minato	1-4-1 Mita	Jan 2017	10,225 tsubo
Sophia University No. 6 Building (Sophia Tower)	17 / 1	Chiyoda	6-1-1 Kojimachi	Jan 2017	4,054 tsubo
GINZA SIX	13 / 5	Chuo	6-10-1 Ginza	Jan 2017	11,495 tsubo
Lattice Aoyama Square	9 / 1	Minato	1-2-6 Minami Aoyama	Jan 2017	1,787 tsubo
Otemachi Park Building	29 / 5	Chiyoda	1-1-1 Otemachi	Feb 2017	18,365 tsubo

Source: Compiled by Xymax Real Estate Institute based on information released by companies

**Figure 12: Major Office Relocations (Q1 2017)**

Company	From	To	Month Year	Purpose	Size
DMM Group	Ebisu Garden Place Tower <i>Shibuya Ward</i>	Sumitomo Fudosan Roppongi Grand Tower <i>Minato Ward</i>	Mar 2017	Consolidation	5,000 tsubo
Rengo	Shinagawa East One Tower <i>Minato Ward</i>	Shinagawa Season Terrace <i>Minato Ward</i>	Mar 2017	Expansion	1,800 tsubo
Mitsubishi Estate	Otemachi Building <i>Chiyoda Ward</i>	Otemachi Park Building <i>Chiyoda Ward</i>	Second Half 2017	N/A	3,500 tsubo
Broadband Tower	Uchisaiwaicho Tokyu Building <i>Chiyoda Ward</i>	Uchisaiwaicho 2-chome Project (temporary name), <i>Chiyoda Ward</i>	Dec 2017	Expansion	629 tsubo
Seibu Holdings	Seibu Holdings Headquarters Building, <i>Saitama Prefecture</i>	Seibu Railway Ikebukuro Building Redevelopment Project (temporary name), <i>Toshima Ward</i>	Spring 2019	Better Location	2,541 tsubo

Source: Compiled by Xymax Real Estate Institute based on information released by companies.

The size of the office space is an estimate.



Overview of Researches				
	Vacancy Rate	Increase and Decrease in Vacant Space	Vacancy Turnover Ratio	New Contract Rent Index
Description	Vacant space versus total office stock in the market.	A quarterly increase and a quarterly decrease in volume of vacant space in the market.	The ratio of the vacant space leased during the quarter to all the vacant office stock in the market.	Office rent index based on new contract rents. This index uses a statistical method to remove property-specific influences such as size and age of buildings.
Main Point	Supply and demand balance in the market	Supply and demand balance in the market	Supply and demand balance in the market	Level of contract rents
Sector	Office Building	Office Building	Office Building	Office Building
Market	Tokyo 23 Wards	Tokyo 23 Wards	Tokyo 23 Wards	Tokyo 23 Wards
Building Size	All	All	All	All / Large / Small & Medium
Release	Every Quarter	Every Quarter	Every Quarter	Every Quarter
Data Source	Data of available vacant spaces and buildings. Independently collected by Xymax.	Data of available vacant spaces and buildings. Independently collected by Xymax.	Data of available vacant spaces and buildings. Independently collected by Xymax.	Data of new contract rents including CAM charge. Independently collected by Xymax.
Data Used in Recent Quarter	30,533 buildings	26,372 contracts	26,372 contracts	724 contracts
How to Calculate	<ul style="list-style-type: none"> <li>• Vacancy rate = vacant space ÷ rentable space</li> <li>• Vacant Space Total available vacant space in completed buildings as of the time of the research.</li> <li>• Rentable Space Rentable space of completed buildings as of the time of the research.</li> </ul> <p>Where rentable space is not available, the rentable space is estimated from the gross floor area of the building using the formula developed in the joint study with the laboratory of Professor Naoki Kato at Kyoto University Graduate School of Engineering.</p>	<ul style="list-style-type: none"> <li>• Increase in volume of vacant space a. Space in existing buildings formerly occupied by tenants b. Total rentable area of new completions</li> <li>• Decrease in volume of vacant space a. Space in existing buildings leased under a new agreement b. Space in new completions but lease is signed prior to the completion c. Space that had been vacant but the owner decided not to lease</li> </ul> <p>Where rentable space is not available, the rentable space is estimated from the gross floor area of the building using the formula developed in the joint study with the laboratory of Professor Naoki Kato at Kyoto University Graduate School of Engineering.</p>	<ul style="list-style-type: none"> <li>• Vacancy Turnover Ratio = Volume of vacant space leased during the quarter ÷ (Initial vacancy + Vacancy added during the quarter) Then, compute the four-quarter moving average amount with the ratio derived from this formula.</li> <li>• Volume of vacant space leased during the quarter: Same as the "decrease in volume of vacant space".</li> <li>• Initial vacancy: Total volume of completed buildings that are available for lease as of the start of the quarter.</li> <li>• Vacancy added during the quarter: Same as the "increase in volume of vacant space"</li> </ul>	<ol style="list-style-type: none"> <li>1) Develop a rolling hedonic model (overlapping period: five quarters) based on the collected new contract data with property-specific factors as variables (location, building size, building age, facilities, date of signing of lease, etc.).</li> <li>2) Estimate the quarterly contract rent by assigning the values of a typical building to the model developed in the preceding step.</li> <li>3) The New Contract Rent Index is the rent estimated in the preceding step based on Q1 2010 as the base point (=100).</li> </ol> <p>This model shows changes in new contract rents after removing property-specific variables.</p>

	Contract Rent DI	Paying Rent Index	Free Rent Granted (%) & Average Free Rent (Month)
Description	Index of changes in new contract rents. Calculated by counting and comparing the buildings where rent has increased and those where rent has decreased.	Index of changes in paying rents (new and existing contract rents).	Distribution of free rent and average length of free rent period. Free rent is the time lag between the start of the contract and the start of the rent payment.
Main Point	Direction of contract rent trends	Level of rents paid by tenants	Market trends that are not reflected in contract rents
Sector	Office Building	Office Building	Office Building
Market	Tokyo 23 Wards / Tokyo Central 3 Wards	Tokyo 23 Wards	Tokyo 23 Wards
Building Size	All	All	All
Release	Every Quarter	Every Quarter	Every Quarter
Data Source	Data of new contract rents including CAM charge. Independently collected by Xymax.	Data of new and existing contracts signed for buildings under management by Xymax.	Data of new contracts signed for buildings under management by Xymax.
Data Used in Recent Quarter	1,305 contracts	3,913 contracts	121 contracts
How to Calculate	<ol style="list-style-type: none"> <li>1) Compare the data of new contract rent per tsubo with that in the 6-month prior period in the same building. Each contract was counted separately into three categories: buildings with "rent increase", "no change" or "rent decrease"</li> <li>2) Calculate the percentage of buildings with "rent decrease" and buildings with "rent increase".</li> <li>3) Subtract the percentage of buildings with "rent decrease" from the percentage of buildings with "rent increase". This outcome is the Contract Rent Diffusion Index (DI).</li> </ol>	<ol style="list-style-type: none"> <li>1) Calculate the rent per tsubo of each tenant from the data of new and existing lease contracts and memorandums.</li> <li>2) Develop a rolling hedonic model (overlapping period: five quarters) based on the rents calculated in the preceding step (the "paying rent") with property-specific factors as variables (location, building size, building age, facilities date of lease, etc.).</li> <li>3) Estimate a quarterly contract rent by assigning the values of a typical building to the model developed in the preceding step.</li> <li>4) The Paying Rent Index is the rent estimated in the preceding step based on Q1 2010 as the base point (=100).</li> </ol> <p>With this method, influences from replacement of sample data and deterioration of buildings over age are removed from the result.</p>	<ul style="list-style-type: none"> <li>• Free Rent Period The period between the start of the contract and the start of the rent, shown in number of days.</li> <li>• Ratio of Free Rent Granted The ratio of contracts with free rent in all the new contracts (excl. contracts for expansion within the building and recontracts)</li> <li>• Average Free Rent (Month) of All the Contracts The simple average of the free rent period including lease contracts with no free rent.</li> <li>• Average Free Rent (Month) of Contracts with Free Rent The simple average of the free rent period of lease contracts with free rent.</li> </ul> <p>In some cases, the rent agreed in a lease contract includes CAM charge, and then, for a certain period of time, the rent is reduced to the CAM charge equivalent or closer level, but such contracts are excluded from this research.</p>

## Office Market Report | Tokyo | Q1 2017

All the contents are as of the date of this report. Xymax Corporation does not guarantee the accuracy or completeness of the information herein. Copying, quoting, forwarding, distributing, reprinting or any other use of this report is not allowed without prior permission from Xymax Real Estate Institute Corporation.

Copyright © 2017 Xymax Corporation. All rights reserved.

## Appendix

### Xymax REI Research Updates January – March 2017

#### Electric Power Consumption by Office Tenants (December 2016) March 3, 2017

- The 12-month moving average consumption for 2016 was 35.9 kWh/tsubo.
- The average consumption for 2016 was a year-on-year decrease by 1.2 kWh/tsubo (3.2%).
- The average consumption per month in Oct-Dec 2016 was 33.7 kWh/tsubo.

#### Energy Consumption and Energy Cost in Office Buildings (December 2016) March 3, 2017

- Energy Consumption: Remained roughly unchanged from the September 2016 quarter.
- Energy Price per Unit: 5 points down from the September 2016 quarter. Started to fall in March 2015.
- Energy Cost: 3 points down from the September 2016 quarter. Decreased in line with the falling consumption and price.

#### Metropolitan Areas Office Demand Survey 2016 | Changing Work Styles and Office January 30, 2017

- It is a survey on how companies are using their office and how people are working there. This issue featured the approaches taken by companies for the changing work styles and the different work places that are becoming more available.

#### Tokyo 23 Wards | Increase and Decrease in Vacant Office Space January 23, 2017

- Xymax studied the increase and decrease in office space using the data of available spaces independently obtained and accumulated by Xymax Group and released a report on the study.

#### Metropolitan Areas Office Demand Survey 2016 | Demand Trends January 12, 2017

- More companies are now allowing a flexible working time and place. This trend is likely to influence the future demand for office space.
- Xymax decided to do a regular research on how companies are using their office and how people are working there and analyze the impact of them on demand for office space. "Demand Trends" is the first publication of this research.

#### Contact

Xymax Real Estate Institute  
Phone: +81 3 3596 1477  
Fax: +81 3 3596 1478  
Email: [info-rei@xymax.co.jp](mailto:info-rei@xymax.co.jp)