Xymax Real Estate Institute

Office Market Report

Tokyo | Q1 2019

May 8, 2019

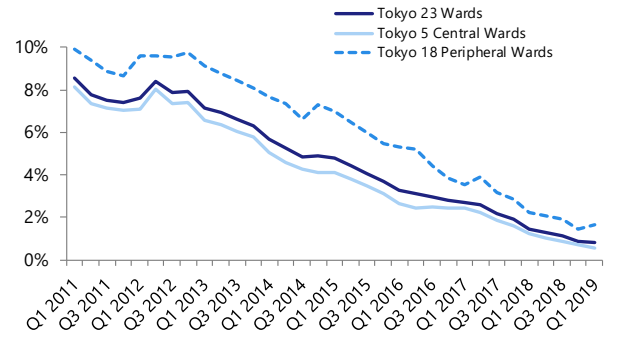
Summary

(1 tsubo = 3.3 sqm)

- In the January–March 2019 quarter, the Tokyo 23 Wards' office market continued to see strong demand for office space and a drop in the vacancy rate, as several large office buildings were nearly filled by the time they were completed, and new vacancies were taken soon after going on the market. The rising trend of new contract rent has also continued.
- The **vacancy rate*** was 0.81%, down 0.06 points from the previous quarter. In terms of the **increase and decrease in vacancies**,* the decrease exceeded the increase, with 106,000 tsubo decreasing and 98,000 tsubo increasing. The **vacancy turnover ratio**,* the rate of decrease in vacant office stock, was unchanged at 53.6%.

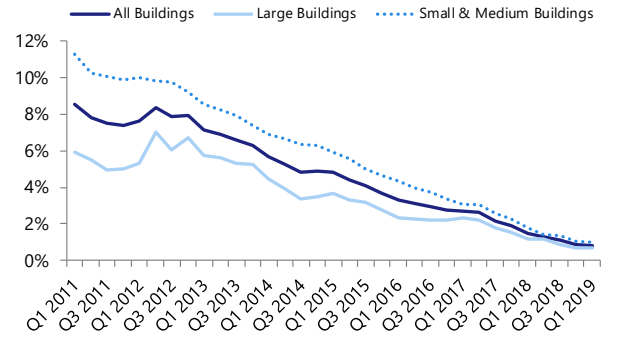
  ***The calculation methods have been changed. Details are described at the end of the report.**
- The **new contract rent index**, the level of new lease rent, was unchanged at 123. The **contract rent diffusion index**, calculated by subtracting the percentage of buildings with a new rent decrease from that of buildings with a new rent increase, remained above zero for the sixteenth consecutive quarter at +19.
- The **paying rent index**, which includes new and existing rents, was 94, up 3 quarter on quarter.
- The **average free rent months of lease with free rent** was 1.5 months and ratio of free rent granted was 46.3%, indicating that, as in Q4 2018, free rent has become common in the market.

Figure 1: Vacancy Rate (by Area)



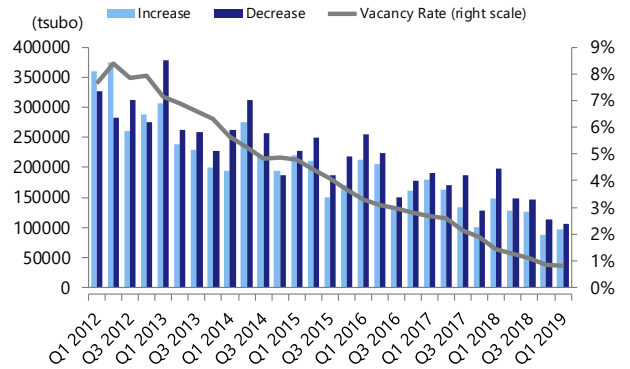
	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019
Tokyo 23 Wards	1.45%	1.29%	1.10%	0.87%	0.81%
Tokyo 5 Central Wards	1.22%	1.04%	0.84%	0.69%	0.55%
Tokyo 18 Peripheral Wards	2.21%	2.07%	1.92%	1.46%	1.65%

Figure 2: Vacancy Rate (by Size)



	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019
All Buildings	1.45%	1.29%	1.10%	0.87%	0.81%
Large Buildings	1.16%	1.15%	0.86%	0.70%	0.68%
Small & Medium Buildings	1.77%	1.43%	1.36%	1.06%	0.95%

Figure 3: Increase and Decrease in Vacancies (23 Wards, All Sizes)



	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019
Increase	149,000	129,000	126,000	88,000	98,000
Decrease	197,000	149,000	147,000	113,000	106,000
Vacancy (right scale)	1.45%	1.29%	1.10%	0.87%	0.81%

Vacancy

Figure 1 shows the **vacancy rate** in the Tokyo 23 Wards, five Central Wards (Chuo, Chiyoda, Minato, Shibuya, and Shinjuku Wards), and 18 Peripheral Wards since 2011. The rate in Q1 2019 hit a record low in the 23 Wards (0.81%) and the five Central Wards (0.55%), while that in the 18 Peripheral Wards rose 0.19 points to 1.65%. This reflects an increase in vacancies due to relocations from the 18 Peripheral Wards to the five Central Wards. A survey*1 by Xymax Real Estate Institute also shows that 66.0% of companies replied that their medium- to long-term office strategy for their head office was to consolidate in the city center with good accessibility, implying the possibility that more companies would move to the five Central Wards.

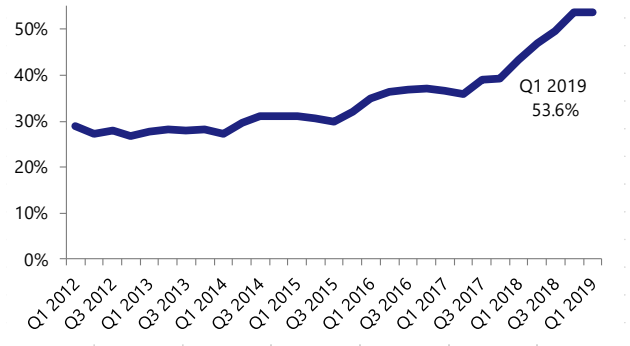
*1 *The Shape of the Office in the future*, released February 6 2019
https://www.xymax.co.jp/english/news_research/?type=research

Figure 2 is the **vacancy rate** of all buildings, large buildings (gross floor area (GFA): 5,000 tsubo or more), and small & medium buildings (GFA: less than 5,000 tsubo) since 2011. In Q1 2019, the rate hit a record low in both large and small & medium building, at 0.68% and 0.95%, respectively.

Figure 3 is the **increase and decrease in vacancies**. The increase was 98,000 tsubo and the decrease was 106,000 tsubo in Q1 2019. The decrease exceeded the increase for 17 consecutive quarters since Q1 2015.

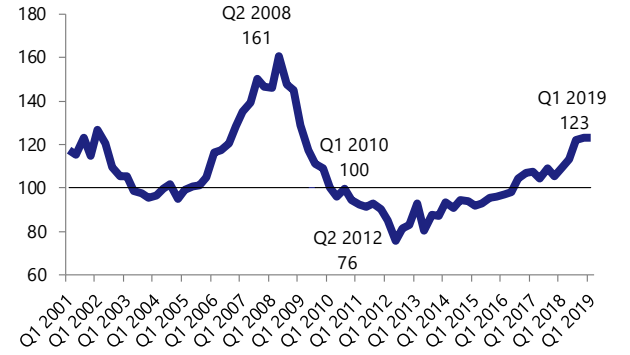
In Q1 2019, several large office buildings were nearly filled by the time they were completed, due to companies' strong demand for expansion in view of a rise in headcount. Formerly occupied spaces were filled from within the building by tenants increasing floor space and did not go on the market, resulting in decreases continuing to exceed increases.

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



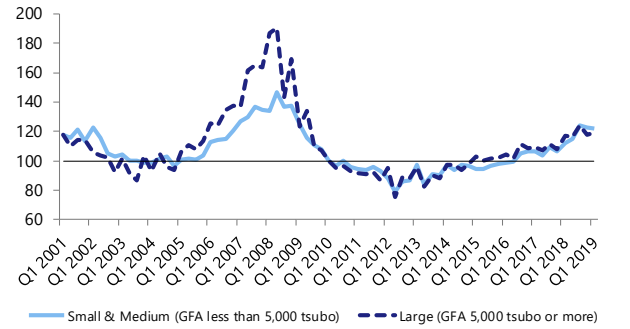
	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019
Vacancy Turnover	43.3%	46.9%	49.6%	53.6%	53.6%

Figure 5: New Contract Rent Index



	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019
New Contract Rent Index	109	113	122	123	123

Figure 6: New Contract Rent Index (by Size)



	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019
Large Buildings	117	116	124	118	119
Small & Medium Buildings	112	115	124	123	122

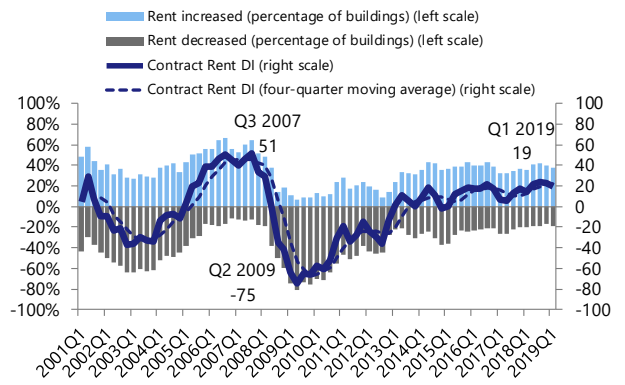
Figure 4 shows the **vacancy turnover ratio (four-quarter moving average)**, the rate of vacancies leased to tenants during the quarter to all the vacant office stock (vacancies at the start of the quarter + vacancies added during the quarter). The ratio in Q1 2019 was 53.6%, unchanged from the previous quarter but up 10.3 points from Q1 2018. The ratio remains high, indicating active vacancy turnover in the office market.

New Contract Rent

Figure 5 is the **new contract rent index**, the index of new lease rent levels. The index for Q1 2019 was 123, unchanged from the previous quarter and up 14 points year on year. The rising trend of new rent since Q2 2012 has continued. Companies' needs for high-spec buildings in the center of Tokyo are especially strong as they look for better locations, which benefits recruitment, consolidation of offices for greater work efficiency, and business continuity plan (BCP) measures. While there are limited options for relocation due to the shortage of vacancies in the market, not many companies can afford high unit prices, which may have led to the lack of a significant rise in new rent.

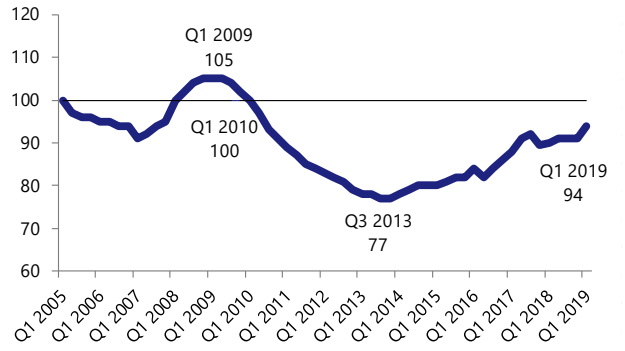
Figure 6 shows the new contract rent index **by size of building**. The index for large buildings with a GFA of 5,000 tsubo or more rose 1 point to 119. Although the index for small & medium buildings with a GFA of less than 5,000 tsubo dropped 1 point from the previous quarter to 122, there was no change to the rising trend that has continued since 2012.

Figure 7: Contract Rent DI



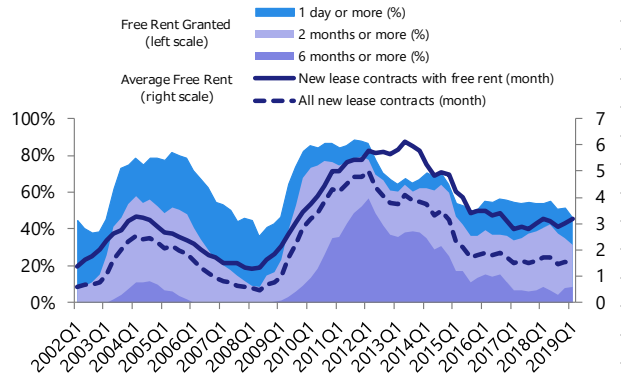
	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019
Contract Rent DI	15	22	23	23	19

Figure 8: Paying Rent Index



	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019
Paying Rent Index	90	91	91	91	94

Figure 9: Free Rent



		Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019
Ratio of Free Rent Granted	1 day +	53.8%	55.2%	50.8%	51.0%	46.3%
	2 mon. +	40.7%	42.1%	37.5%	35.3%	31.4%
	6 mon. +	8.4%	6.7%	4.2%	7.9%	8.2%
Average Free Rent Months	All	1.7	1.7	1.5	1.5	1.5
	w/ FR	3.2	3.1	2.9	3.0	3.2

Figure 7 is the **contract rent diffusion index (DI)** (the percentage of buildings with rent rises minus the percentage of buildings with rent declines), which indicates the direction of changes in new lease rents. The DI in Q1 2019 was +19, indicating there were more buildings with a higher rent than six months ago than those with a lower rent. The DI remained above zero for 16 consecutive quarters.

Paying Rent

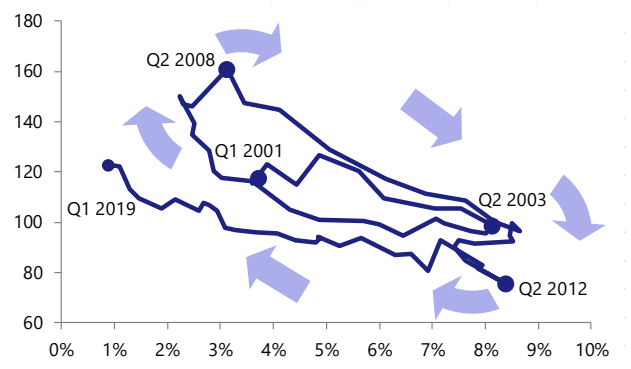
Figure 8 shows the **paying rent index**, which covers both new lease rents and existing lease rents. The index in Q1 2019 was 94, up 3 points from the previous quarter. Amid a record low vacancy rate and a strong sense of scarcity of vacancies, owners take a tough stance in negotiating a rent rise with tenants. We therefore believe that the mild rising trend since 2013 slightly accelerated in Q1 2019.

Free Rent

Figure 9 indicates the percentage of new lease contracts with free rent to all new lease contracts (**ratio of free rent granted**) and the average free rent period (**average free rent months**). In Q1 2019, the average free rent months were 3.2 months for leases with free rent, a slight increase of 0.2 months from Q4 2018, and 1.5 months for all new leases, unchanged from the previous quarter.

As in Q4 2018, there is a certain amount of free rents, both long-term and short-term. Short-term free rent has become common in the market as owners grant tenants free rent in consideration of the tenants' relocation costs and construction work period. On the other hand, some owners set a high rent to maintain the value of the office building and grant long-term free rent.

Figure 10: Market Cycle



	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019
Vacancy Rate	1.45%	1.29%	1.10%	0.87%	0.81%
New Contract Rent Index	109	113	122	123	123

Note: The vacancy rate before March 2011 is based on data by a major leasing agent.

Market Cycle

Figure 10 plots the vacancy rate on the horizontal axis and the new contract rent index on the vertical axis on a quarterly basis. It shows the cyclicality of the market, with the chart trending to the lower right in 2001 (vacancy up, rent down), remaining static in 2003–2004, then trending to the upper left in 2005 (vacancy down, rent up) and to the lower right again in 2008 (vacancy up, rent down).

The market entered a recovery phase in 2013, with the trend continuing in 2019. During Q1 2019, the chart moved to the upper left due to a drop in the vacancy rate and unchanged rent.

Changes in calculation methods related to the vacancy rate

In order to better reflect the supply and demand balance of the office market in vacancy-related indicators (vacancy rate, increase and decrease in vacancies, vacancy turnover ratio), we reviewed the conditions of the targets of calculation and carried out a recalculation, including past data. We will apply the changes starting from this report (Q1 2019) but will not replace the reports we have released in the past.

The data that we have recalculated retrospectively can be found in our website (please refer to the URL below). Those who are using the time series data for the vacancy rate, increase and decrease in vacancies, vacancy turnover ratio, and market cycle (Figures 1–4 and 10) are requested to replace the data.

*The data after the changes can be found below.

https://soken.xymax.co.jp/wp-content/uploads/2019/05/1905-office_market_report_q1_2019_data.xlsx

Reference

Figure 11: Major Building Completions (Q1 2019)

Name	Floors Above Ground / Below Ground	Ward	Address	Completion	Total floor area (tsubo)
DaiyaGate Ikebukuro	20/2	Toshima	1-16-15 Minamiikebukuro	2019/02	15,022
Abema Towers	21/2	Shibuya	40-1 Udagawachō	2019/02	11,478
Shinagawa HEART	26/2	Minato	1-8-23 Kōnan	2019/02	11,050
Nihonbashi Muromachi Mitsui Tower	26/3	Chuo	2-3-1 Nihonbashimuromachi	2019/03	50,820
SHIBUYA SOLASTA	21/1	Shibuya	1-21-1 Dōgenzaka	2019/03	14,204

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

Figure 12: Major Office Relocations (Q1 2019)

Company	From	To	Month Year	Purpose	Size (tsubo)
Japan Aviation Electronics	Shibuya Dogenzaka Tokyu building *Shibuya Ward*	SHIBUYA SOLASTA *Shibuya Ward*	May 2019	Expansion	528
ThreePro Group Inc. (Company name after August 1, 2019: GiG Works Inc.)	Nishishinjuku Daikyo Building *Shinjuku Ward*	Toranomon Twin Building (East) *Minato Ward*	Aug 2019	Better efficiency	600
Nishimoto Co.,Ltd.	Onward Park Building *Chuo Ward*	Nihonbashi Muromachi Mitsui Tower *Chuo Ward*	Sep 2019	Expansion	1,300
ES-CON JAPAN Ltd.	Try Edge Ochanomizu *Chiyoda Ward*	The Okura Prestige Tower *Minato Ward*	Oct 2020	Expansion	688
SoftBank Corp.	Tokyo Shiodome Building *Minato Ward*	Takeshiba Area Development Project *Minato Ward*	2020	BCP strengthening	24,000
NN Life Insurance	The New Otani Garden Court *Chiyoda Ward*	SHIBUYA SCRAMBLE SQUARE East Building *Shibuya Ward*	Spring of 2020	BCP strengthening	1,700

Source: Complied by Xymax Real Estate Institute based on information released by companies.
The sizes of office space are estimates.

Survey Overview

	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			
Market	Tokyo 23 Wards			
Building Size	GFA 300 tsubo or more	GFA 300 tsubo or more	GFA 300 tsubo or more	GFA 300 tsubo or more
Release	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	8,467 buildings	4,179 contracts	4,179 contracts	475 contracts
How to Calculate	• Vacancy rate = vacant space ÷ rentable space • Vacant Space Total available vacant space in completed buildings as of the time of the research. • Rentable Space Rentable space of completed buildings as of the time of the research. 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.	• Increase in volume of vacant space a. Space in existing buildings formerly occupied by tenants b. Total rentable area of new completions • 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 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.	• 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. • Volume of vacant space leased during the quarter: Same as the "decrease in volume of vacant space). • Initial vacancy: Total volume of completed buildings that are available for lease as of the start of the quarter. • Vacancy added during the quarter: Same as the "increase in volume of vacant space"	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.). 2) Estimate the quarterly contract rent by assigning the values of a typical building to the model developed in the preceding step. 3) The New Contract Rent Index is the rent estimated in the preceding step based on Q1 2010 as the base point (=100). This model shows changes in new contract rents after removing property-specific variables.

Survey Overview

	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		
Market	Tokyo 23 Wards		
Building Size	All	GFA 300 tsubo or more	All
Release	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	824 contracts	3,926 contracts	255 contracts
How to Calculate	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" 2) Calculate the percentage of buildings with "rent decrease" and buildings with "rent increase". 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).	1) Calculate the rent per tsubo of each tenant from the data of new and existing lease contracts and memorandums. 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 signing of lease, etc.). 3) Estimate a quarterly contract rent by assigning the values of a typical building to the model developed in the preceding step. 4) The Paying Rent Index is the rent estimated in the preceding step based on Q1 2010 as the base point (=100). With this method, influences from replacement of sample data and deterioration of buildings over age are removed from the result.	• Free Rent Period The period between the start of the contract and the start of the rent, shown in number of days. • 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) • Average Free Rent (Month) of All the Contracts The simple average of the free rent period including lease contracts with no free rent. • Average Free Rent (Month) of Contracts with Free Rent The simple average of the free rent period of lease contracts with free rent. 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.

Appendix: Xymax REI Research Updates (February – April 2019)

The Shape of the Office in the Future February 6, 2019

- In this report we conducted a questionnaire survey of companies on workstyles and the places for work. It summarizes the shape of the office in the future.

Office Specifications Changing with Time February 13, 2019

- This report summarizes the changes in the specifications of buildings that constitute the office stock, with regard to the Tokyo 23 Wards Office Stock Pyramid 2019 released on January 23, 2019.

Please contact below for inquiries on this report

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