

Office Market Report

Tokyo | Q2 2020

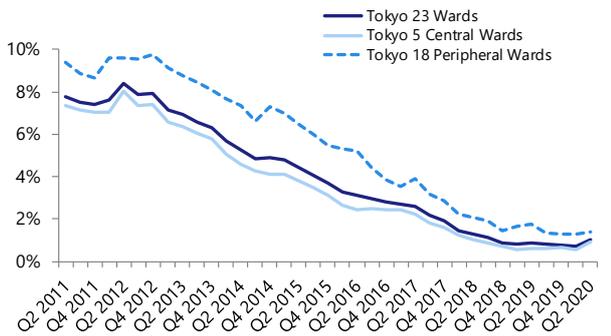
August 5, 2020



Summary

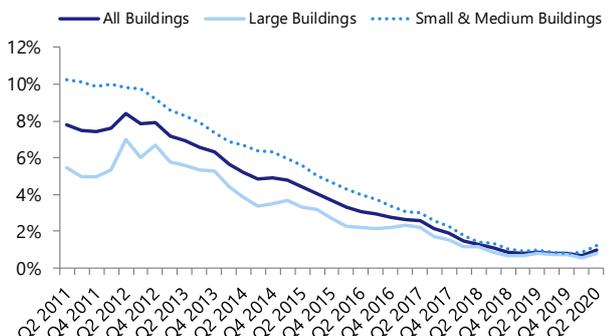
- In Q2 (April–June) 2020, the office market of the 23 wards of Tokyo (“Tokyo 23 Wards”) showed signs of change as demand for office space declined and vacancy rates rose.
- The **vacancy rate** was 1.01%, up 0.30 percentage points from the previous quarter. The **increase and decrease in vacant space** showed that vacant space increased by 117,000 tsubo (1 tsubo = approx. 3.3 sqm) and decreased by 86,000 tsubo, the first time the increase exceeded the decrease in four quarters. The **vacancy turnover ratio**, which is the rate of decrease of vacant office stock, dropped 24.0 percentage points quarter on quarter to 46.4%.
- The **new contract rent index**, the level of new lease rent, was 128, down 9 points from the previous quarter. The **contract rent diffusion index**, which is the percentage of buildings with a rise in new rent minus that of buildings with a drop in new rent, declined by 25 points from the previous quarter to +18.
- The **paying rent index**, which includes both new and existing rents, was 103, up 2 points quarter on quarter.
- The **average free rent months of lease with free rent** was 0.9 months, 0.3 months less from the previous quarter, while the ratio of free rent offered was 34.3%, down 2.3 percentage points.
- **TOPIC:** The **monthly trend of vacant space** between January and June 2020 indicates a consistent rise in vacant space since March.

Figure 1: Vacancy Rate (by Area)



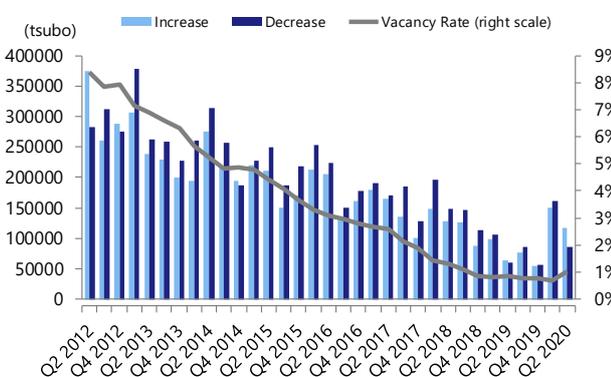
	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020
Tokyo 23 Wards	0.87%	0.79%	0.78%	0.71%	1.01%
Tokyo 5 Central Wards	0.59%	0.62%	0.63%	0.54%	0.89%
Tokyo 18 Peripheral Wards	1.77%	1.36%	1.28%	1.27%	1.37%

Figure 2: Vacancy Rate (by Size)



	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020
All Buildings	0.87%	0.79%	0.78%	0.71%	1.01%
Large Buildings	0.79%	0.73%	0.74%	0.58%	0.82%
Small & Medium Buildings	0.96%	0.86%	0.83%	0.85%	1.21%

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



	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020
Increase	63,000	77,000	54,000	150,000	117,000
Decrease	60,000	86,000	56,000	162,000	86,000
Vacancy (right scale)	0.87%	0.79%	0.78%	0.71%	1.01%

Vacancy

Figure 1 shows the **vacancy rates** in Tokyo 23 Wards, 5 Central Wards (Chuo, Chiyoda, Minato, Shibuya, and Shinjuku Wards), and 18 Peripheral Wards since 2011. The rate in Q2 2020 rose by 0.30 points from Q1 to 1.01% in the 23 Wards, by 0.35 points to 0.89% in the 5 Central Wards, and by 0.10 points to 1.37% in the 18 Peripheral Wards. The vacancy rate rose in all three areas, reflecting a fall in companies' office expansion needs.

Factors for the rise in vacancy rates include companies refraining from expanding their office by relocating amid uncertainties toward the future of the economy and a rise in difficulties finding the next tenant for new vacant space after a tenant has relocated to another building.

Figure 2 shows the **vacancy rates** of all sizes of buildings, large buildings (gross floor area (GFA): 5,000 tsubo or more), and small & medium buildings (GFA: less than 5,000 tsubo) in Tokyo 23 Wards since 2011. In Q2 2020, the vacancy rate rose by 0.24 points to 0.82% among large buildings and by 0.36 points to 1.21% among small & medium buildings.

Figure 3 is the **increase and decrease in vacant space**. In Q2 2020, the increase in vacant space was 117,000 tsubo while the decrease was 86,000 tsubo. The increase in vacant space exceeded the decrease for the first time in four quarters as the speed of vacancies being taken in existing buildings slowed compared to the previous quarter, despite vacancies of new buildings continuing to be promptly filled.

Figure 4: Vacancy Turnover Ratio

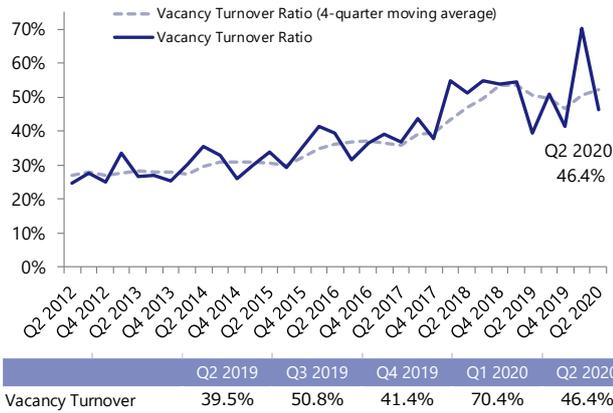


Figure 4 shows the **vacancy turnover ratio**, the ratio of vacant spaces leased to tenants during the quarter to the total vacant office stock (vacant office stock at start of quarter + vacant space added during the quarter). The ratio in Q2 2020 dropped by 24.0 percentage points from the previous quarter to 46.4%. Although the ratio remains high, we must carefully monitor future developments of the market since vacancy rates are rising and the market environment is changing.

*From Q2 2020, the vacancy turnover ratio is indicated in quarterly figures. The previous figures are indicated as “vacancy turnover ratio (four-quarter moving average).”

Figure 5: New Contract Rent Index



New Contract Rent

Figure 5 is the **new contract rent index**, which is the rent level for new lease contracts. The index for Q2 2020 was 128, dropped by 9 points quarter on quarter and up 1 point year on year. New rent has continued to rise since Q2 2012. There have been strong expansion needs on the back of an increase in personnel, but some companies have started to become cautious about expanding. Furthermore, the rising trend of rent may have peaked out as companies become sensitive toward rent levels.

Figure 6: New Contract Rent Index (by Size)

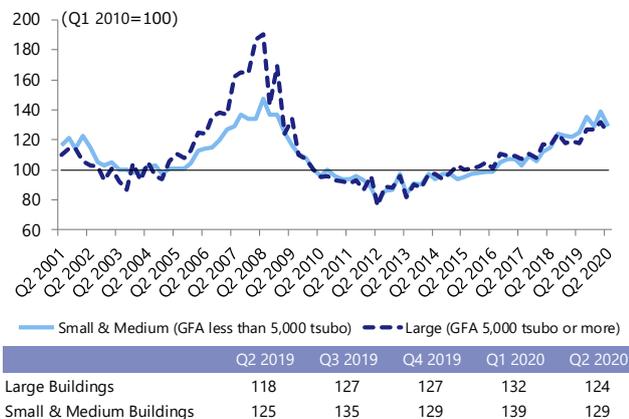


Figure 6 is the new contract rent index **by size of building**. The index for large companies with a GFA of 5,000 tsubo or more dropped by 8 points quarter on quarter to 124, while that for small & medium buildings with a GFA of less than 5,000 tsubo fell by 10 points to 129. Although the index has seen a quarter-on-quarter decline before, this time it accompanies a rise in vacancy rates, which suggests a change in the tide in rent.

Figure 7: Contract Rent DI

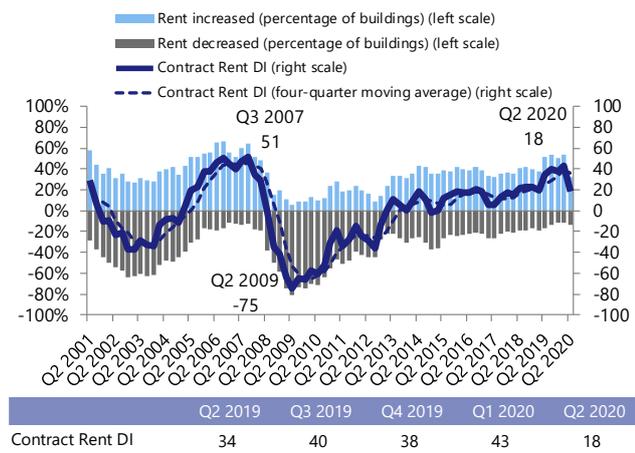
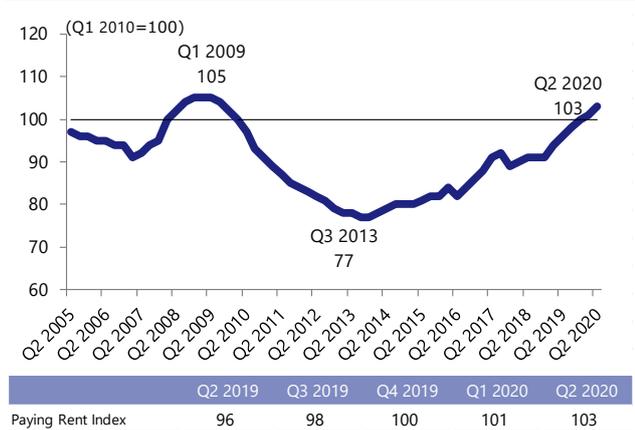


Figure 7 is the **contract rent diffusion index (DI)** (the percentage of buildings with a rent rise minus that of buildings with a rent decline), which indicates the direction of changes in new contract rents. The DI in Q2 2020 was +18: there were more buildings with higher new rent than six months ago than those with lower new rent. However, the index fell by 25 points from Q1. Although the DI has remained above zero for 21 consecutive quarters, the percentage of buildings with a rent rise dropped sharply in Q2. Meanwhile, the percentage of buildings with a rent decline rose slightly, marking a shift in the market.

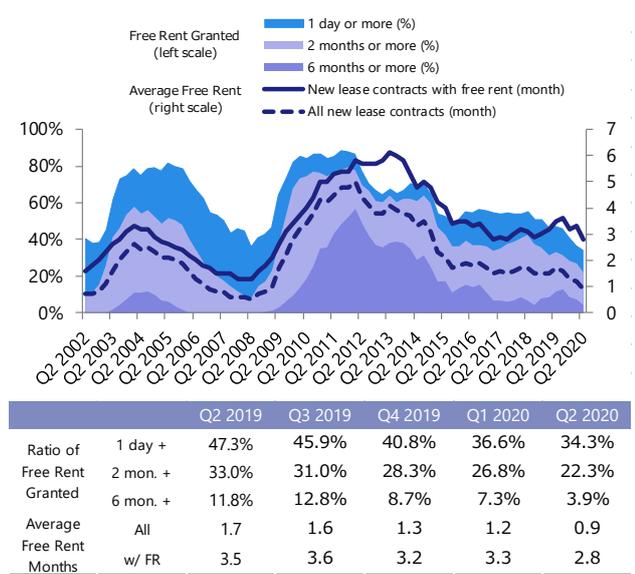
Figure 8: Paying Rent Index



Paying Rent

Figure 8 shows the **paying rent index**, which includes both new lease rents and existing lease rents. The index in Q2 2020 was 103, up 2 points quarter on quarter and up 7 points year on year. The upward trend since Q3 2013 has continued. As there has been a fall in office demand recently, future developments must be monitored carefully since existing lease rents, which account for a majority of paying rent, are usually revised when contracts are renewed and tend to change more slowly than new lease rents.

Figure 9: Free Rent

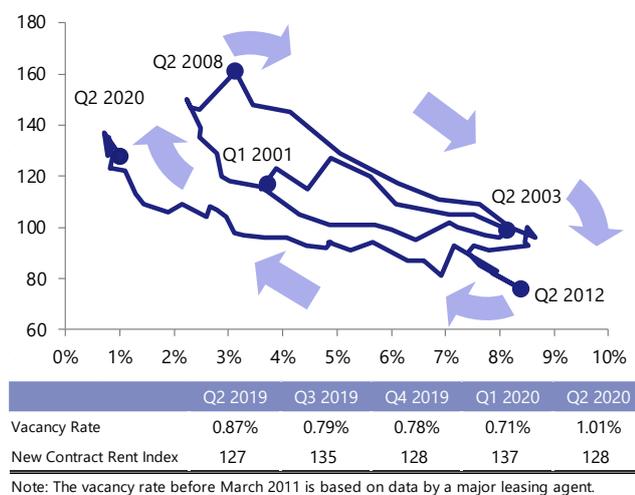


Free Rent

Figure 9 is the percentage of new lease contracts with free rent to all new lease contracts (**ratio of free rent offered**) and the average free rent period (**average free rent months**). In Q2 2020, the average free rent months was 2.8 months among lease contracts with free rent, 0.5 months less than in Q1, and 0.9 months among all new contracts, 0.3 months less than Q1.

The ratio of free rent offered, which had been dropping since 2011, has remained flat since around 2016, indicating that offering free rent has become common across the market. We will pay close attention to future developments of free rent amid changes in the market going forward.

Figure 10: Market Cycle



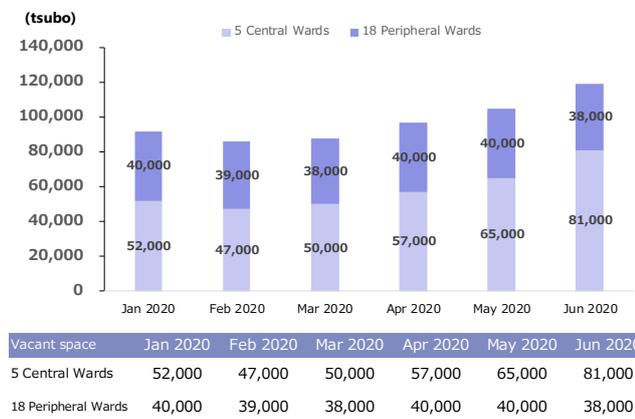
Market Cycle

Figure 10 plots the vacancy rate on the horizontal scale and the new contract rent index on the vertical scale on a quarterly basis. It shows the cyclicity of the market, with the chart trending to the lower right in 2001 (vacancy up, rent down), remaining flat 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).

Although the office lease market had been in a recovery phase since 2013, the chart trended to the lower right as vacancy rates rose while the new contract rent index dropped in Q2 2020.

TOPIC

Figure 11: Trend of Vacant Space (Jan-Jun 2020)



Monthly Trend of Vacant Space

In this report, we created a chart of the monthly change in vacant space between January and June 2020 (for Tokyo’s 5 Central Wards and 18 Peripheral Wards) in order to examine the shift in the market in more detail. Vacant space in the 23 Wards as a whole has consistently increased since March, when the impact of the new coronavirus started to emerge in full swing. In the 5 Central Wards, vacant space has increased every month from 47,000 tsubo in February and reached 81,000 tsubo in June. On the other hand, vacant space in the 18 Peripheral Wards has remained largely unchanged at around 38,000 tsubo.

Reference

Figure 12: Major Building Completions (Q2 2020)

Name	Floors		Ward	Address	Completion	Total floor area (tsubo)
	Above ground/	Below ground				
WATERS takeshiba	26/2		Minato	1-10-30 Kaigan	Apr 2020	18,846
Office Tower, Tokyo Portcity Takeshiba	40/2		Minato	1-7-1 Kaigan	May 2020	55,071
Hareza Tower	33/2		Toshima	1-18-1 Higashi-Ikebukuro	May 2020	20,753
Tokyo Toranomom Global Square	24/3		Minato	1-3 Toranomom	Jun 2020	14,296

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

Figure 13: Major Office Relocations (Q2 2020)

Company	From	To	Timing	Purpose	Size (tsubo)
bitA	BR Gotanda <i>Shinagawa Ward</i>	NMF Gotanda Ekimae Bldg. <i>Shinagawa Ward</i>	Jun 2020	Expansion	213
Nojima	Queen's Tower B <i>Yokohama city</i>	JR Yokohama Tower <i>Yokohama city</i>	Jul 2020	Greater efficiency	930
Fuji Xerox	Roppongi T-Cube <i>Minato Ward</i>	Toyosu Bayside Cross Tower <i>Koto Ward</i>	Autumn 2020	Greater efficiency	6,000
Fujimori Kogyo Co., Ltd.	Shinjuku First West <i>Shinjuku Ward</i>	BUNKYO GARDEN GATETOWER <i>Bunkyo Ward</i>	Nov 2020	Expansion	777

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

The sizes of offices 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	8,606 buildings	4,899 contracts	4,899 contracts	363 contracts
How to Calculate	<ul style="list-style-type: none"> • 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. <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"> • Increase in volume of vacant space <ol style="list-style-type: none"> a. Space in existing buildings formerly occupied by tenants b. Total rentable area of new completions • Decrease in volume of vacant space <ol style="list-style-type: none"> 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 <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"> • Vacancy Turnover Ratio = Volume of vacant space leased during the quarter ÷ (Initial vacant space + Vacant space added during the quarter) • Volume of vacant space leased during the quarter: Same as "Increase and Decrease in Vacant Space" • Initial vacant space: Total volume of areas available for lease in completed buildings as of the start of the quarter. • Vacant space added during the quarter: Same as "Increase and Decrease in Vacant Space" 	<ol style="list-style-type: none"> 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). <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		
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	425 contracts	4,164 contracts	233 contracts
How to Calculate	<ol style="list-style-type: none"> 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). 	<ol style="list-style-type: none"> 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). <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"> • 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. <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>

Appendix: Xymax REI Research Updates (May 2020 – July 2020)

Energy Consumption and Energy Cost in Office Buildings (December 2019) May 15, 2020

- This report is a summary of the results of a survey on the energy consumption and energy cost in office buildings in the Greater Tokyo area.

Considering the Future Workplace June 10, 2020

- This report outlines the situation prior to the corona crisis (until the end of 2019 to be specific) in order to consider work styles and the workplace during the corona crisis (today's society, with the priority on preventing the spread of the virus) and after the crisis (the society after movement restrictions have been lifted), based on various surveys in Japan and abroad as well as interviews with experts.

Companies' Work Styles and the Workplace under the Corona Crisis July 15, 2020

- This report is a summary of companies' responses to the corona crisis and the issues they have revealed, as well as companies' current ideas toward future office strategies, based on a questionnaire survey on work styles and the workplace under the corona crisis.

"Top Ten Issues Affecting Real Estate 2020-21" by U.S. Counselors of Real Estate July 20, 2020

- This report is a Japanese version of *Top Ten Issues Affecting Real Estate*®, an annual report by the Counselors of Real Estate® (CRE) of the U.S. published in June 2020, translated at Xymax Real Estate Institute that is headed by Yoshio Nakayama, who is also a member of CRE and a member of its International Committee.

Metropolitan Areas Office Demand Survey Spring 2020 July 29, 2020

- This report is a summary of the results of a semiannual questionnaire survey on the situation of companies' office use and work styles and a continuous analysis of the relationship between office demand.

For further inquiries please contact:

Xymax Real Estate Institute

<https://soken.xymax.co.jp>

E-MAIL: info-rei@xymax.co.jp