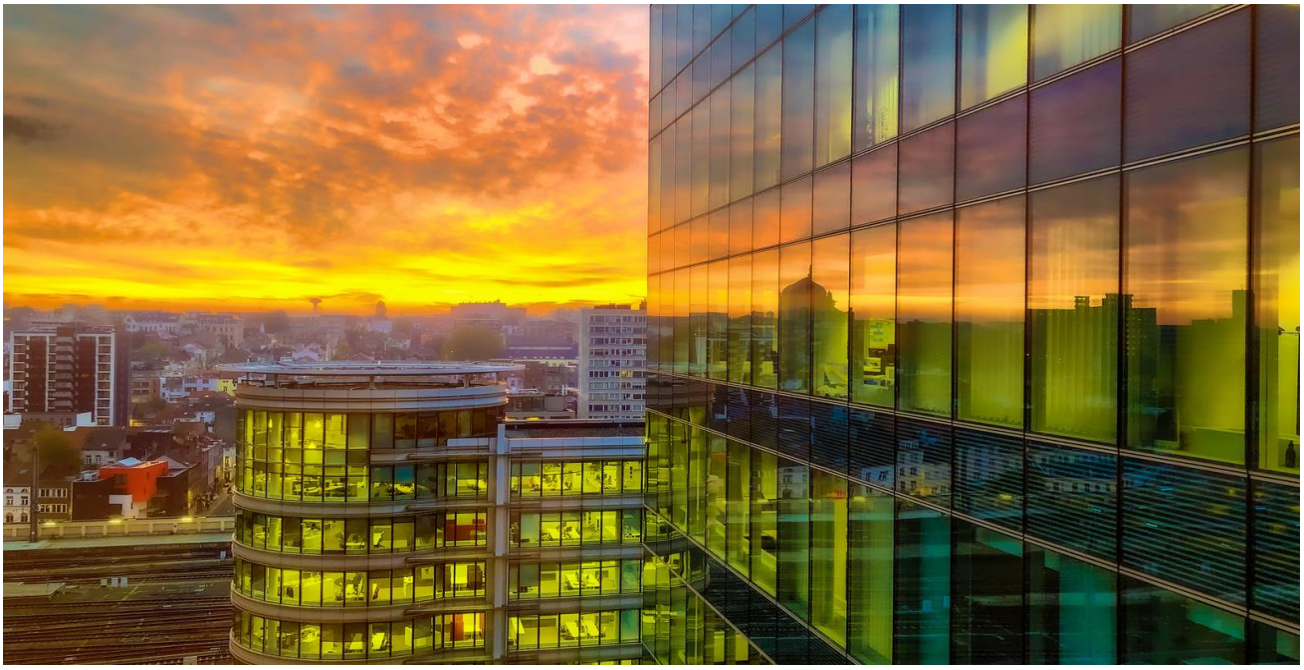
Office Market Report

Tokyo | Q3 2021

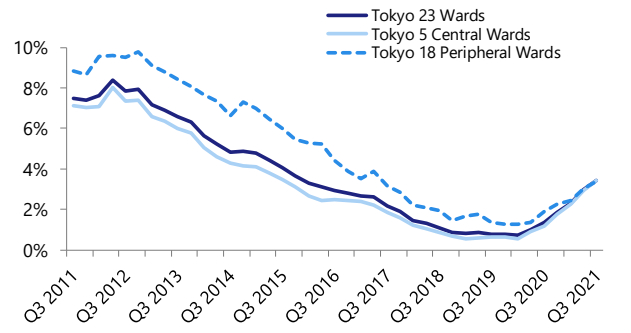
October 27, 2021



Summary

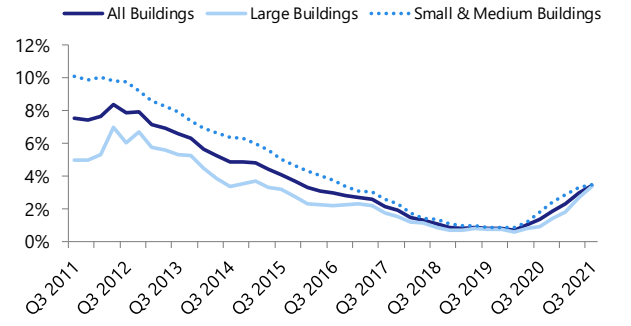
- In Q3 (July–September) 2021, the office market of the 23 wards of Tokyo ("Tokyo 23 Wards") continued to see supply of offices outweighing demand, with vacancy rates rising and rent levels dropping.
- The **vacancy rate** was 3.41%, up 0.45 pp from the previous quarter. The **availability rate**, which includes space for which a cancellation notice has been given and vacant space currently available (accepting tenant applications), was 5.91%, up 0.16 pp from the previous quarter. The **increase and decrease in vacant space** showed that the increase in vacant space outweighed the decrease for the sixth consecutive quarter, as vacant space increased by 190,000 tsubo (1 tsubo = approx. 3.3 sqm) and decreased by 144,000 tsubo. The **vacancy turnover ratio**, which is the ratio of vacant spaces leased to tenants, dropped 7.4 pp quarter on quarter to 27.1%.
- The **new contract rent index**, which is the level of new lease rent, was 86, down 3 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, rose 5 points from the previous quarter to -31, a negative figure for the fourth consecutive quarter.
- The **paying rent index**, which includes both new and existing rents, dropped 1 point to 103.
- The **average number of free rent months** among all new lease contracts was 1.7 months. The **ratio of free rent offered** was 65.3%.

Figure 1: Vacancy Rate (by Area)



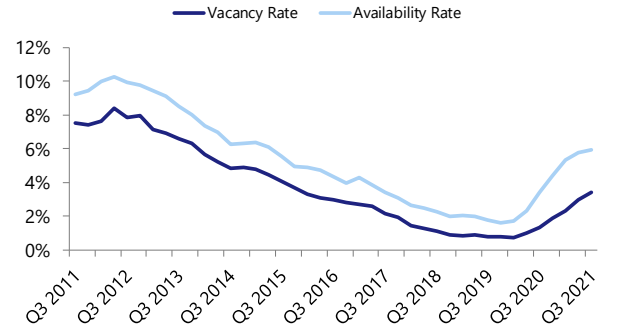
	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
Tokyo 23 Wards	1.34%	1.87%	2.30%	2.96%	3.41%
Tokyo 5 Central Wards	1.17%	1.74%	2.24%	2.93%	3.41%
Tokyo 18 Peripheral Wards	1.90%	2.26%	2.46%	3.04%	3.40%

Figure 2: Vacancy Rate (by Building Size)



	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
All Buildings	1.34%	1.87%	2.30%	2.96%	3.41%
Large Buildings	0.93%	1.39%	1.78%	2.67%	3.37%
Small & Medium Buildings	1.81%	2.40%	2.87%	3.29%	3.45%

Figure 3: Availability Rate (23 Wards, All Sizes)



	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
Vacancy Rate	1.34%	1.87%	2.30%	2.96%	3.41%
Availability Rate	3.42%	4.42%	5.31%	5.75%	5.91%

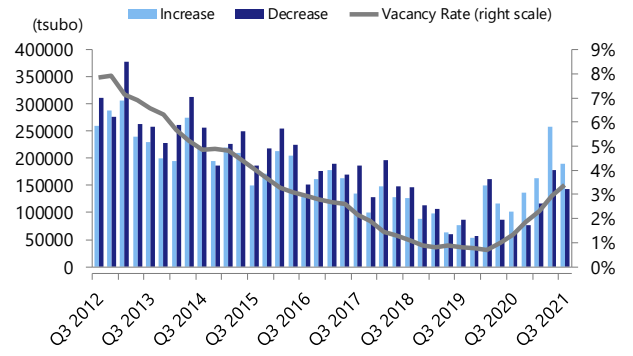
Vacancy

Figure 1 shows the **vacancy rates** of Tokyo 23 Wards, the 5 Central Wards (Chuo, Chiyoda, Minato, Shibuya and Shinjuku Wards) and the 18 Peripheral Wards since 2011. The rate in Q3 2021 was +0.45 pp from Q2 at 3.41% in the 23 Wards, +0.48 pp at 3.41% in the 5 Central Wards, and +0.36 pp at 3.40% in the 18 Peripheral Wards. The rate rose in all three areas for the sixth consecutive quarter. The rise in the vacancy rate was especially large in the 5 Central Wards, reducing the gap in the rate with the 18 Peripheral Wards. The difference between areas is diminishing compared to before the COVID-19 pandemic. A likely cause for the rate rise is companies with multiple offices consolidating their offices into a single office, reducing their total office space than before the relocation.

Figure 2 shows the **vacancy rate** of all sizes of buildings, large buildings (gross floor area (GFA): 5,000 tsubo or more) and small & medium buildings (GFA: 300–4,999 tsubo) in Tokyo 23 Wards since 2011. In Q3 2021, the vacancy rate rose by 0.70 pp to 3.37% among large buildings and by 0.16 pp to 3.45% among small & medium buildings.

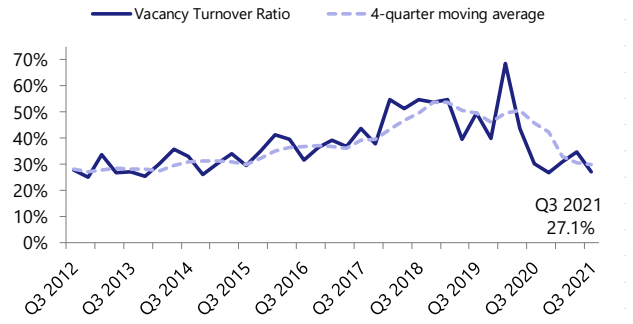
Figure 3 shows the trend of the **availability rate** and the **vacancy rate**. The availability rate is the sum of currently vacant space, space for which a cancellation notice has been given and space that is accepting tenant applications (before the previous tenant has left) as the numerator, and rentable space as denominator. The rate in Q3 2021 rose 0.16 pp from Q2 to 5.91%, a smaller rise than the 0.45-pp rise in the vacancy rate. The narrowing gap between the availability rate and the vacancy rate vs Q2 suggests a drop in lease cancellations or a mild rise in cases where the next tenant is found before the previous tenant vacated the building.

Figure 4: Increase and Decrease in Vacant Space (23 Wards, All Building Sizes)



	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
Increase	102,000	136,000	164,000	258,000	190,000
Decrease	65,000	77,000	116,000	179,000	144,000
Vacancy (right scale)	1.34%	1.87%	2.30%	2.96%	3.41%

Figure 5: Vacancy Turnover Ratio



	Q4 2020	Q1 2021	Q1 2021	Q2 2021	Q3 2021
Vacancy Turnover	32.4%	26.8%	30.9%	34.5%	27.1%

Figure 6: New Contract Rent Index

	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
New Contract Rent Index	102	92	90	89	86

Note: The new contract rent index has been revised retrospectively starting Q1 2021.

Figure 4 is the **increase and decrease in vacant space**. In Q3 2021, the increase in vacant space was 190,000 tsubo, while the decrease was 144,000 tsubo. The increase exceeded the decrease for the sixth consecutive quarter. In Q3, both the increase and decrease in vacant space were smaller than in Q2, since there was less office space completed in Q3 compared to Q2. However, as both the increase and decrease in vacant space have nearly doubled on a year-on-year basis and the **number of company relocation decisions** has been increasing since Q4 2020, according to a report released by Xymax Real Estate Institute in October,*1 companies may have become more active in relocating, as they now have more choices of relocation destinations due to the increase in vacant space.

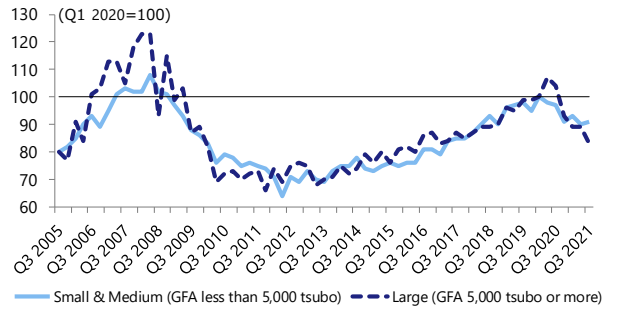
*1 *Dissecting the Recent Rise in Vacancy Rates*, released on October 1, 2021 (in Japanese only) https://soken.xymax.co.jp/2021/10/01/2110-rise_in_vacancy_rates/

Figure 5 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 Q3 2021 dropped 7.4 pp from Q2 to 27.1%. We will monitor future developments carefully.

New Contract Rent

Figure 6 is the **new contract rent index**, the rent level for new lease contracts. The index for Q3 2021 was 86, -3 points from Q2 and -16 points from Q3 2020. The trend of new contract rent, which had risen since Q2 2012, turned downward after peaking in Q2 2020. The continued weakness in new contract rent reflects the sense of alarm held by many lessors at the prospect of a further increase in vacancies.

Figure 7: New Contract Rent Index (by Size)

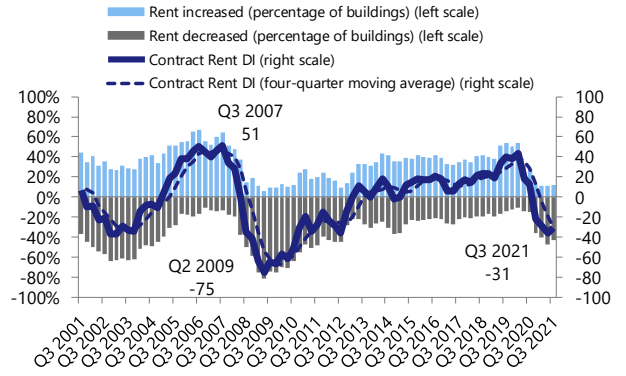


	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
Large Buildings	104	93	89	89	83
Small & Medium Buildings	97	91	93	90	91

Note: The new contract rent index has been revised retrospectively starting Q1 2021.

Figure 7 is the new contract rent index **by size of building**. The index for large companies with a GFA of 5,000 tsubo or more was -6 points from Q2 at 83, while that for small & medium buildings with a GFA of 300–4,999 tsubo was +1 point at 91.

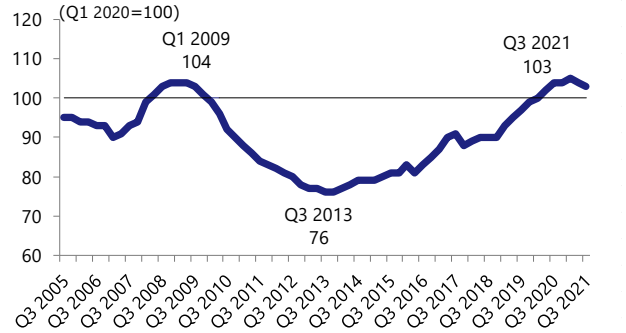
Figure 8: Contract Rent DI



	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
Contract Rent DI	13	-22	-29	-36	-31

Figure 8 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 rent. The DI in Q3 2021 was -31, a negative figure for the fourth consecutive quarter. A negative DI means there were more buildings with lower new rent than those with higher new rent compared to six months ago. However, since the index has risen 5 points from Q2, we will monitor future developments carefully.

Figure 9: Paying Rent Index

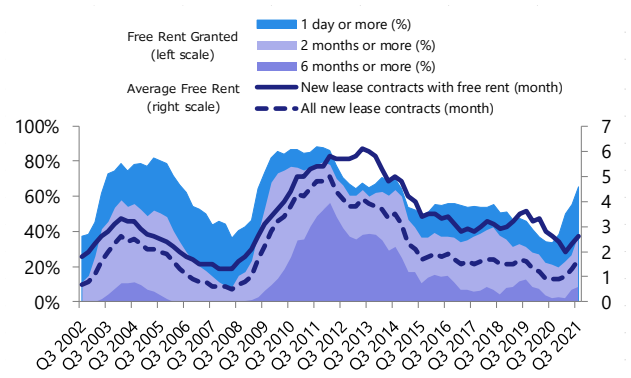


	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
Paying Rent Index	104	104	105	104	103

Paying Rent

Figure 9 shows the **paying rent index**, which includes both new lease rents and existing lease rents. The index changes more slowly than new contract rent. Although the index in Q3 2021 dropped 1 point from Q2 to 103, paying rent was roughly flat from Q2, as not a lot of negotiations for existing rent cuts took place.

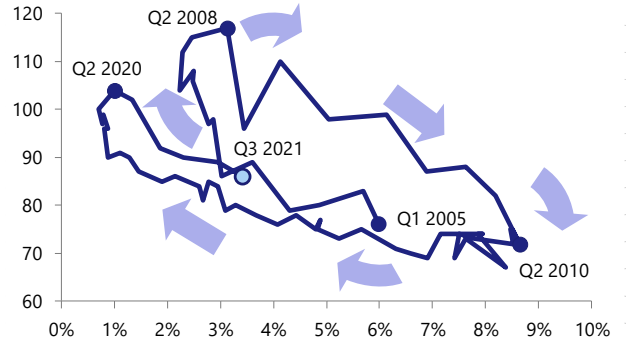
Figure 10: Free Rent



		Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
Ratio of Free Rent Granted	1 day +	33.8%	38.2%	50.2%	55.5%	65.3%
	2 mon. +	20.9%	19.5%	22.5%	26.4%	36.9%
	6 mon. +	2.2%	2.4%	1.9%	6.6%	8.4%
Average Free Rent Months	All	0.9	0.9	1.0	1.3	1.7
	w/ FR	2.6	2.4	2.0	2.3	2.6

Note:The aggregation method has changed starting Q1 2021

Figure 11: Market Cycle



	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
Vacancy Rate	1.34%	1.87%	2.30%	2.96%	3.41%
New Contract Rent Inde	102	92	90	89	86

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

Free Rent

Figure 10 shows 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 Q3 2021, the ratio of offering free rent for one day or more was 65.3%, while that for six months or more was 8.4%. The average number of free rent months was 2.6 among lease contracts with free rent and 1.7 among all new contracts. The ratio of offering free rent in Q3 2021 rose by nearly 10 pp from Q2, which suggests that more lessors are trying to attract tenants by offering free rent.

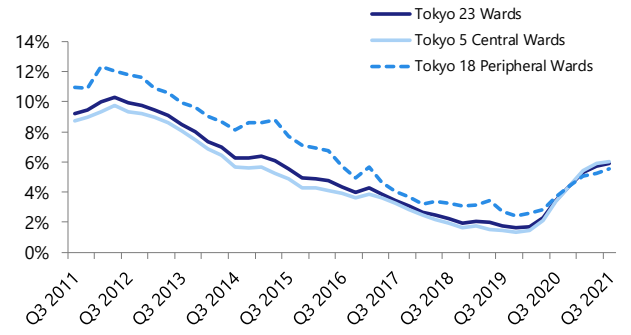
Market Cycle

Figure 11 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 cyclicality of the market, with the chart trending to the upper left from 2005 (vacancy down, rent up), returning to the lower right from 2008 (vacancy up, rent down) and then trending to the upper left (vacancy down, rent up) from 2010.

The trend of the office lease market, which had been in a recovery phase since 2013, seems to have changed in Q2 2020. The chart trended to the lower right in Q3 2021, as vacancy rates rose and new contract rent index fell.

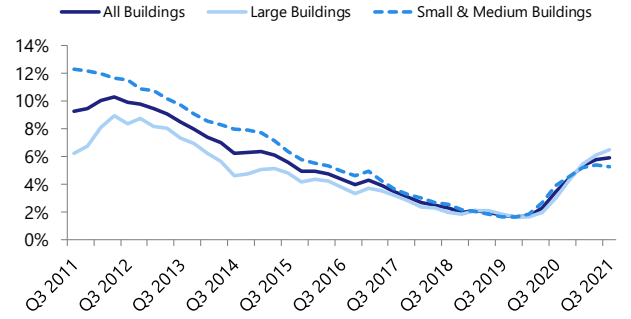
TOPIC

Figure 12: Availability Rate (by Area)



	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
Tokyo 23 Wards	3.42%	4.42%	5.31%	5.75%	5.91%
Tokyo 5 Central Wards	3.35%	4.43%	5.40%	5.91%	6.03%
Tokyo 18 Peripheral Wards	3.65%	4.38%	5.04%	5.24%	5.52%

Figure 13: Availability Rate (by Building Size)



	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021
All Buildings	3.42%	4.42%	5.31%	5.75%	5.91%
Large Buildings	3.00%	4.31%	5.44%	6.10%	6.48%
Small & Medium Buildings	3.90%	4.54%	5.17%	5.40%	5.26%

Availability Rate by Area and Building Size

As a TOPIC, we are examining the availability rate by area and building size. Figure 12 shows the **availability rate** of Tokyo 23 Wards, the 5 Central Wards and the 18 Peripheral Wards since 2011. The rate in Q3 2021 rose by 0.12 pp to 6.03% in the 5 Central Wards and by 0.28 pp to 5.52% in the 18 Peripheral Wards. The availability rate rose for the seventh consecutive quarter regardless of area.

Figure 13 shows the **availability rate** at all sizes of buildings, large buildings (GFA: 5,000 tsubo or more) and small & medium buildings (GFA: 300–4,999 tsubo) in Tokyo 23 Wards since 2011. In Q3 2021, the rate rose by 0.38 pp to 6.48% at large buildings but dropped by 0.14 pp to 5.26% at small & medium buildings. As in Q2, the rate at large buildings was larger than the rate at all sizes of buildings.

Reference

Figure 14: Major Building Completions (Q3 2021)

Name	Floors Above ground/ Below ground	Ward	Address	Completion	Total floor area (tsubo)
VPO Higashi-nihombashi	9	Chuo	3-4-13 Higashi-nihombashi	Jul 2021	1,165
MEBKS TOYOSU	12	Koto	6-4-34 Toyosu	Aug 2021	26,673
Sumitomo Fudosan Kanda-izumicho Building	8/1	Chiyoda	1-9-2 Kanda-izumicho	Sep 2021	3,033

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

Figure 15: Major Office Relocations (Q3 2021)

Company	From	To	Timing	Purpose	Size (tsubo)
JFE Shoji Corporation	JFE Shoji Bldg *Chiyoda Ward*	Shin Otemachi Bldg *Chiyoda Ward*	Oct 2021~	Aggregation	4,881
Kokusai Kogyo Co., Ltd.	Rokubancho K Bldg *Chiyoda Ward*	Shinjuku Front Tower *Shinjuku Ward*	Nov 2021	Greater efficiency	1,000
NorthSand, Inc.	HULIC Ginza Bldg *Chuo Ward*	KABUKIZA Tower *Chuo Ward*	Dec 2021	Increase in personnel	236
CHIC Holdings INC.	Yotsuya ISY Bldg *Shinjuku Ward*	KDX Iidabashi Square *Shinjuku Ward*	Dec 2021	Greater efficiency	140
BOT Lease Co., Ltd.	Tokyo Nohombashi Tower *Chuo Ward*	Tokyo Sumitomo Twin Bldg *Chuo Ward*	Mar 2022	Greater efficiency	800

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 and available 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	8,671 buildings	11,162 contracts	11,162 contracts	366 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. ・Availability rate ＝available space ÷ rentable space ・Available space Total available space, which consist of vacant space and space for which notice of cancellation has been given. 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) Calculate the rent estimated in the preceding step based on Q1 2020 as the base point (=100) by market segment (four segments). 4) Integrate the figure of the preceding step as a Fisher index using gross floor area as weight. The New Contract Rent Index of the Tokyo office market is the integrated figure. This model shows changes in new contractrents after removing property-specificvariables.

	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	480contracts	4,085 contracts	56 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 (Until Q4 2020) The period between the start of the contract and the startof the rent, shown in number of days. (Q1 2021 onward) The period for new contracts (excl. contracts for expansion within building and recontracts) during which rent has continuously been reduced to an amount equivalent or close to CAM charges since the date of contract. ・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 period. ・Average Free Rent (Month) of Contracts with Free Rent The simple average of the free rent period of lease contracts with a free rent period

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