Office Market Report

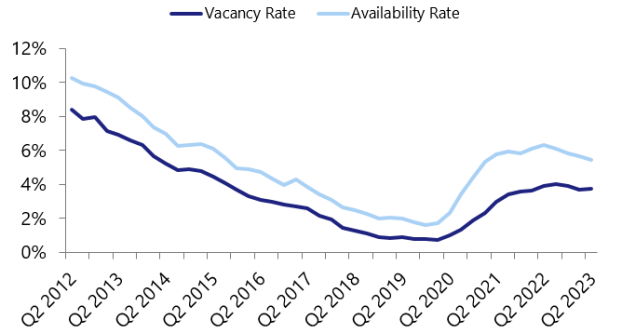
Tokyo | Q2 2023

July 25, 2023

Summary

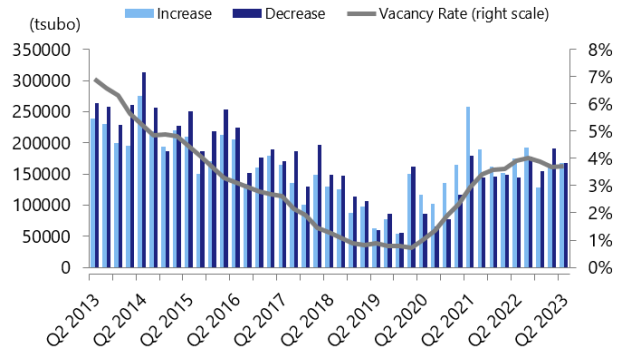
- In Q2 (April–June) 2023, the office market of the 23 wards of Tokyo ("Tokyo 23 Wards") remained flat relative to the previous quarter, with the vacancy rate rising marginally and rent levels declining slightly.
- The **vacancy rate** was 3.71%, up 0.03 pt from Q1 2023. The **availability rate**, which includes space for which a cancellation notice has been given and vacant space currently available (i.e., accepting tenant applications), was 5.45%, down 0.19 pt from Q1 2023. In terms of the **increase and decrease in vacant space**, the increase and the decrease were equal, both at 167,000 tsubo (1 tsubo = approx. 3.3 sqm). The **vacancy turnover ratio**, the ratio of vacant spaces leased to tenants, dropped 2.8 pt from Q1 2023 to 29.7%.
- The **new contract rent index**, the level of new lease rent, was 89, down 1 pt from Q1 2023. The **contract rent diffusion index**, the percentage of buildings with new lease rent that increased minus that of buildings with new lease rent that decreased, dropped 3 pt from Q1 2023 to -11, a negative territory for the eleventh consecutive quarter.
- The **paying rent index**, which includes new and existing rents, was 105, up 2 pt from Q1 2023.
- The **average number of free rent months among lease contracts with free rent** was 3.6 months, the **ratio of free rent for two months or more** was 39.3%, and that for **six months or more** was 11.5%.

FIGURE 1: VACANCY RATE & AVAILABILITY RATE (ALL SIZES)



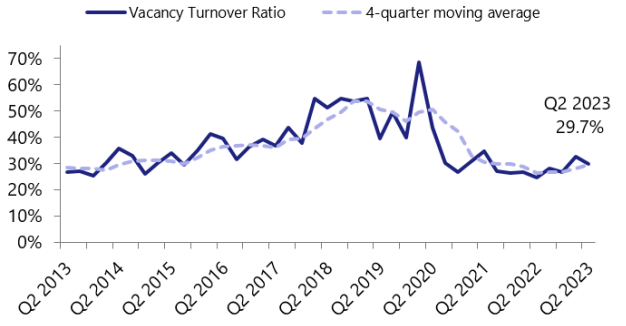
	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
Vacancy Rate	3.91%	4.02%	3.88%	3.68%	3.71%
Availability Rate	6.31%	6.11%	5.81%	5.64%	5.45%

FIGURE 2: INCREASE AND DECREASE IN VACANCIES (23 WARDS, ALL SIZES)



	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
Increase	175,000	192,000	128,000	161,000	167,000
Decrease	144,000	178,000	155,000	191,000	167,000
Vacancy (right scale)	3.91%	4.02%	3.88%	3.68%	3.71%

FIGURE 3: VACANCY TURNOVER RATIO



	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
Vacancy Turnover	24.8%	28.2%	26.8%	32.5%	29.7%

Vacancy

Figure 1 shows the **vacancy rate** and the **availability rate**.*1*2 The vacancy rate of Tokyo 23 Wards in Q2 2023 rose 0.03 pt from Q1 to 3.71%, and the availability rate was down 0.19 pt at 5.45%. The availability rate declined for the fourth consecutive quarter as the increase in new occupancy continued to outpace cancellation notices. However, the change in both the vacancy rate and the availability rate was small, indicating that there was no significant change from Q1 2023. Since large-scale buildings are scheduled for completion in the near future, we must continue to carefully watch the impact of these projects.

*1 Availability rate: 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) divided by rentable space

*2 For the rates by building size and area, see *Vacant Office Space Monthly Report Tokyo | June 2023*, released on July 5, 2023. https://www.xymax.co.jp/english/research/images/pdf/20230705.pdf

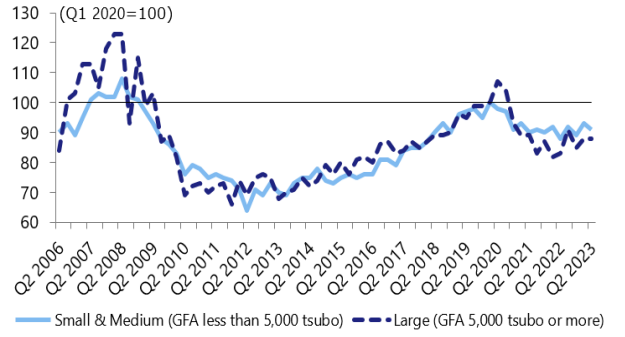
Figure 2 shows the **increase and decrease in vacant space**. The increase and decrease were equal in Q2 2023, both at 167,000 tsubo. While a chain of vacancies associated with new supply occurred, such vacancies were filled by demand for office expansion & relocation and sub-offices as employees began to return to offices and by short-term lease for BPO (business process outsourcing) purposes.

Figure 3 is 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 was 29.7% in Q2 2023, down 2.8 pt from Q1.

FIGURE 4: NEW CONTRACT RENT INDEX

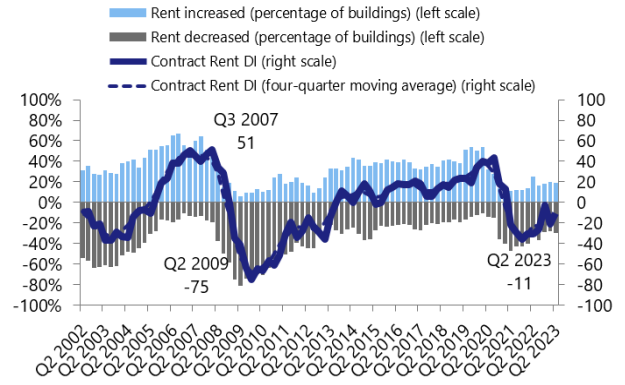
	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
New Contract Rent Index	85	91	87	90	89

FIGURE 5: NEW CONTRACT RENT INDEX (BY SIZE)



	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
Large Buildings	83	91	85	88	88
Small & Medium Buildings	88	92	89	93	91

FIGURE 6: CONTRACT RENT DI



	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
Contract Rent DI	-19	-21	-11	-8	-11

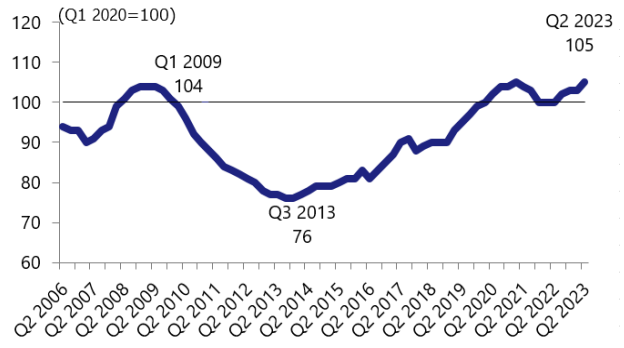
New Contract Rent

Figure 4 is the **new contract rent index**, which indicates the rent level for new lease contracts. The index for Q2 2023 was 89, down 1 pt quarter on quarter and up 4 pt year on year. Having been rising gradually over the past year as the impact of COVID-19 abated and people began to anticipate the normalization of economic activity, new rent remained flat this quarter due to balanced supply and demand.

Figure 5 shows the new contract rent index **by building size**. The index for large buildings with a gross floor area (GFA) of 5,000 tsubo or more was unchanged from Q1 at 88, and that for small & medium buildings with a GFA of 300–less than 5,000 tsubo was down 2 pt at 91. New rent levels for both large buildings and small & medium buildings have been rising gradually or trending flat over the past year, with no difference in trend by the size of building.

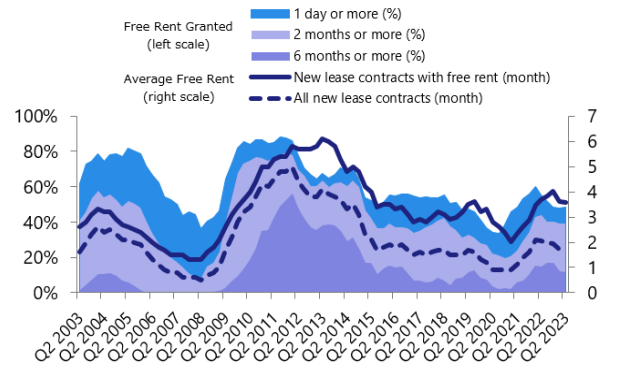
Figure 6 is the **contract rent diffusion index (DI)** (the percentage of buildings with new contract rent that increased compared to six months ago minus that of buildings with decreased rent), which indicates the direction of change in new contract rent. In Q2 2023, the DI was -11, down 3 pt from Q1 and in negative territory for the eleventh consecutive quarter. A negative DI means there are more buildings with a rent decrease than those with a rent increase. After recording smaller negative figures for the last two consecutive quarters, the DI posted a larger negative figure this quarter. We believe this to be due to building owners, who had been raising asking rent, easing the pace of rent rises as vacancy increases and decreases have balanced out.

FIGURE 7: PAYING RENT INDEX



	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
Paying Rent Index	100	102	103	103	105

FIGURE 8: FREE RENT



		Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
Ratio of Free Rent Granted	1 day +	55.4%	51.7%	48.5%	48.0%	48.3%
	2 mon. +	43.8%	40.0%	40.3%	39.0%	39.3%
	6 mon. +	14.6%	17.0%	16.7%	12.2%	11.5%
Average Free Rent Months	All	2.0	2.0	1.9	1.7	1.7
	w/ FR	3.7	3.8	4.0	3.6	3.6

FIGURE 9: MARKET CYCLE

	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
Vacancy Rate	3.91%	4.02%	3.88%	3.68%	3.71%
New Contract Rent Index	85	91	87	90	89

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

Paying Rent

Figure 7 shows the **paying rent index**, which includes both new and existing lease rents. The index lags new contract rent and has less volatility. The index for Q2 2023 was 105, up 2 pt from Q1. There were cases where rent rise negotiations were made at the time of the lease renewal with tenants who moved in when rent levels were relatively low, such as in 2020 at the height of the pandemic.

Free Rent

Figure 8 shows the percentage of new lease contracts that granted free rent (FR) (**ratio of granting FR**) and the average free rent period (**average FR months**). In Q2 2023, the ratio of granting FR for one day or more was 48.3%, up 0.3 pt from Q1, that for two months or more was 39.3%, up 0.3 pt, and that for six months or more was 11.5%, down 0.7 pt. The average number of FR months among lease contracts with FR was 3.6, the same as in Q1. With no significant changes in the vacancy rate or rent levels, FR also trended flat.

Market Cycle

Figure 9 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 (vacancy down, rent up) in 2005, moving to the lower right (vacancy up, rent down) in 2008, and returning to the upper left (vacancy down, rent up) in 2010. In Q2 2023, both the vacancy rate and the new contract rent index were flat, with the cycle roughly unchanged from Q1. The office market is currently calm, having remained in a range for the past year since the downward trend that started in Q3 2020.

Reference

Figure 10: Major Building Completions (Q2 2023)

Name	Floors Above ground/ Below ground	Ward	Address	Completion	Total floor area (tsubo)
Takamatsu Construction Group Tokyo Headquarter	18/1	Minato	4-8-2 Shiba	May 2023	4,987
HANEDA INNOVATION CITY ZONE B	6	Ota	1-1-4 Haneda Airport	Jun 2023	8,309
Rokumaru Gate Ikebukuro	11/2	Toshima	1-13-7,10 Higashi-Ikebukuro	Jun 2023	3,299

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

Figure 11: Major Office Relocations (Q2 2023)

Company	From	To	Timing	Purpose	Size (tsubo)
KDDI	Garden Air Tower *Chiyoda Ward*	TAKANAWA GATEWAY CITY *Minato Ward*	2025	Realizing the decentralized smart city	28,500
Komatsu Ltd.	Komatsu Head Office Bld *Minato Ward*	Shiodome Bld *Minato Ward*	Jan 2024	Head Office Bld reconstruction	3,177
The Rokinren Bank	Labour Banks Hall *Chiyoda Ward*	Central Shin-Otemachi Bld *Chiyoda Ward*	Oct 2026	Head Office Bld reconstruction	1,978

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	8,831 buildings	11,642 contracts	11,642 contracts	753 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	• 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.

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	689 contracts	4,583 contracts	44 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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