

# Office Market Report

Tokyo | Q4 2015

February 3, 2016



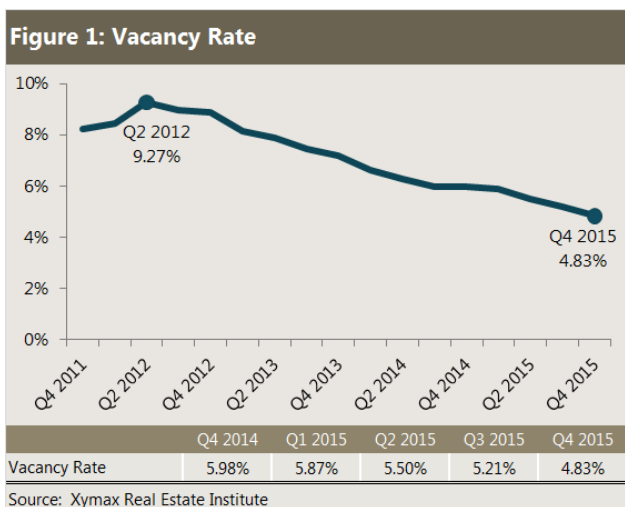
## Summary

- Tokyo 23 Wards' overall office market continued to see a shortage of available space because of the strong demand from corporate tenants. Even so the growth of new rents remained modest. Companies are taking forward-looking relocation strategies, such as seeking better location, expanding space or moving to a high-grade building. The buildings that meet such demands achieved higher rents, but overall rental growth was probably affected by the decreasing or unchanging rents of buildings that failed to meet such demands.
- Vacancy rates decreased for 14 straight quarters, dropping 0.38 points to 4.83%. Overall market vacancy decreased steadily. Available space has been in short supply particularly that of large buildings in high-demand areas.
- New Contract Rent Index (level of new rents) was 96; no change from previous quarter. Contract Rent DI (percentage of buildings with rent increase minus percentage of buildings with rent decrease) was +18.
- Paying Rent (level of new rents and existing rents combined) was 82; no change from previous quarter.
- Average Free Rent Month was 2.6 months, an increase of 0.4 month from previous quarter. Six-month free rents were given to 24.6% of all the contracts, an increase of 8.1 points from previous quarter; after a sharp drop in the previous quarter, the level is now equivalent that of two quarters ago.

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## Vacancy

Figure 1 shows changes in vacancy rates in Tokyo 23 Wards since 2011. The vacancy rates in the fourth quarter of 2015 decreased for the 14th consecutive quarter by 0.38 points to 4.83% from 5.21% in the previous quarter.

Overall market is reducing vacancies thanks to the strong demand from companies of all industries and the limited volume of supply.

Tokyo's central five wards are particularly in high demand. Shibuya and Chiyoda Wards have only a small volume of remaining vacancies and new vacant space is soon taken by new tenants. In Chuo, Minato and Shinjuku Wards, vacant spaces in large buildings have decreased drastically.

Small and medium buildings in the five wards are also successful in reducing vacancies if the buildings offered convenient environment and their exterior and interior gave a good impression.

This can be explained that the main purposes of relocation now come from forward-looking strategies aiming to achieve business expansion rather than the negative purposes commonly seen since 2008 such as restructuring.

Companies planning a forward-looking relocation are facing a need to expand office space for the expected increase of workforce or for the business expansion plan. Some companies wish to move to a high-grade building to enhance the corporate brand for business expansion or to attract future workers. In such case, the desirable buildings should have a sizable space, convenient location, good-looking exterior and interior and be well-equipped.

Some companies decided to postpone or cancel their relocation plan because there are not many available office spaces that suit their demand. Instead of relocation, the companies changed the floor layout, decided to use a storage space outside their office building, encouraged paperless work style or decided to have a small sub-office space in prime location to attract job candidates.

In the survey of new supply<sup>\*1</sup> released at the end of 2015 by Xymax Real Estate Institute, the new supply in Tokyo 23 Wards is 180,000 tsubo (rentable area) in 2016 and 140,000 tsubo in 2017. This level is equivalent to or less than the ten-year average of 180,000 tsubo per year. If assuming demands from corporate tenants for office space to continue, the market will likely continue to reduce its vacancies in the meanwhile.

\*1 Supply of New office Space 2016 (Tokyo & Osaka)

1 tsubo = 3.3 sqm

### New Contract Rent

Figure 2 shows changes in new Contract Rent Index, an index of rent agreed for new lease. The fourth quarter of 2015 was 96; no change from the previous quarter. While available space is increasingly more limited, the overall market is seeing a modest increase of contract rents.

Figure 3 shows changes in New Contract Rent Index by size of building. Small and medium office buildings (gross floor area: below 5,000 tsubo) and large office buildings (gross floor area: over 5,000 tsubo) both had a marginal increase from previous quarter to 98 and 102, respectively.

Large buildings in high-demand areas are more likely to meet the demand from companies with forward-looking relocation plan and the new rents of such buildings continue to show a steady growth. In Shibuya Ward, the rental growth is particularly notable in buildings of any size.

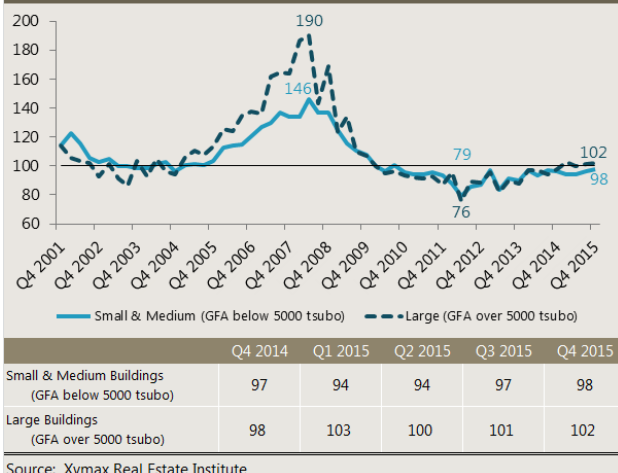
Unlike large buildings, the rental growth of small and medium buildings remained slow. Buildings located in the less convenient area, with less attractive exterior and interior and low-grade equipment, are unlikely to be chosen by potential tenants. As a result, the new rents of such buildings are flat or on the decrease in all building sizes.

Figure 2: New Contract Rent Index

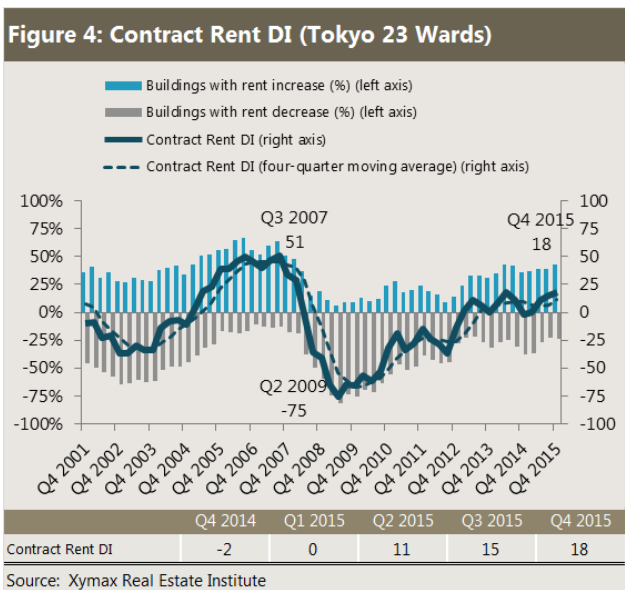


Source: Xymax Real Estate Institute

Figure 3: New Contract Rent Index by Size of Building

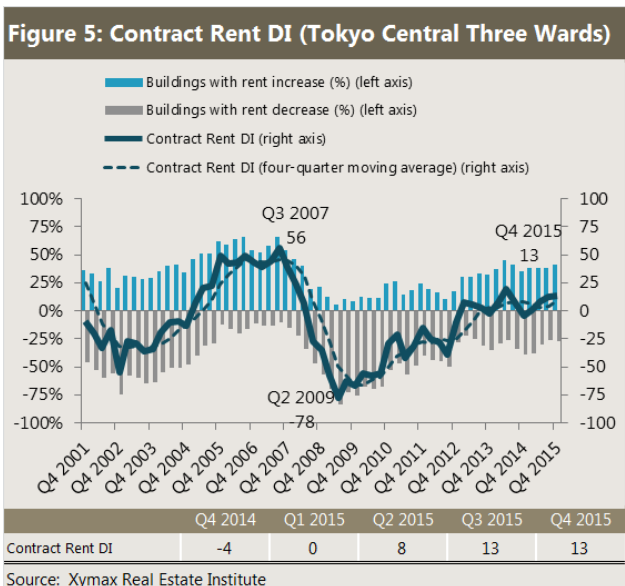


Source: Xymax Real Estate Institute



Figures 4 and 5 are changes in Contract Rent Diffusion Index (DI). The fourth quarter of 2015 was +18 for Tokyo 23 Wards and +13 for Central Three Wards, both increased for three quarters in a row, indicating that the number of buildings with rent increase continued to exceed the number of buildings with rent decrease.

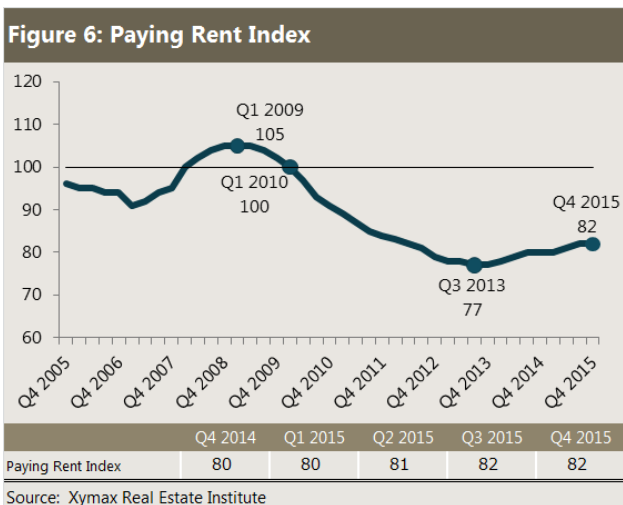
A breakdown of DI indicates that the percentage of the buildings with rent increase was 42%, a quarter-on-quarter increase of 4 points, influenced by the rental growth of large buildings in good and central location and also rents of other buildings located slightly away from terminal stations also increased if large spaces are available. The market recovery is expanding across Tokyo.



However, there are also buildings with rent decrease, accounting for approximately 24% or increase of 1 point quarter-on-quarter. Leasing of less competitive buildings located outside of the central five wards or those with low-grade equipment are struggling. Owners have no way but to reduce the rent to increase the occupancy rate.

The market is getting ready for owners to increase rents thanks to the recent strong market trends that boosted the occupancy rate. Owners, however, continue to be careful on rapid rent increase. The priority of many owners is to recover the weak income since 2008 to an appropriate level.

Increasing rents in buildings that do not match corporate tenant's forward-looking demand remain difficult. The rents are flat or decreasing. These situations influenced the slow growth of the rent level in the overall market.

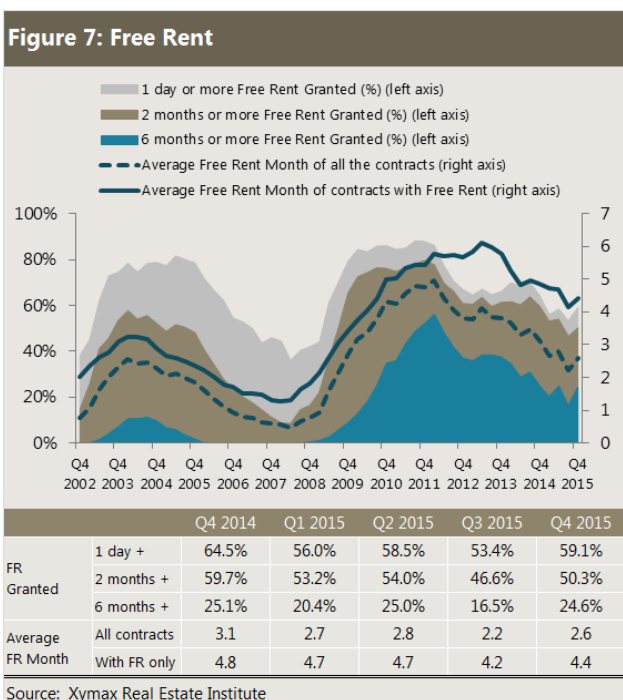


### Paying Rent

Paying Rent Index, of which new contract rents and existing rents are both surveyed, show changes in the rents paid by companies for office space and the income generated from office buildings. Figure 6 shows changes since 2005.

Paying Rent Index was 82 in the fourth quarter of 2015; no change from previous quarter (based on Q1 2010=100). Paying Rent Index is on a rise, albeit very modest, after bottoming in the third quarter of 2013.

Due to the decrease in available space and the increase of rents in new contracts, it is becoming more difficult for companies to find an office space as convenient as and similar building grade to their current office without allowing a rent increase.



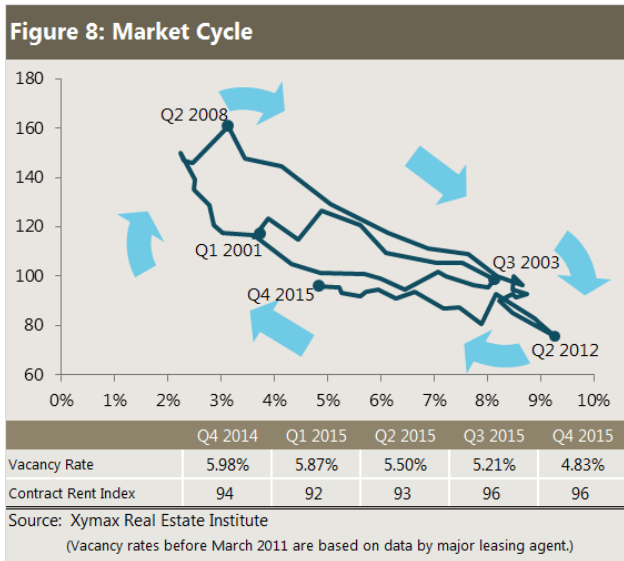
### Free Rent

Figure 7 shows changes in the free rents given to all the new contracts (Ratio of Free Rent Granted) and changes in the average free rent period (Average Free Rent Month).

Ratio of Free Rent Granted increased in the fourth quarter of 2015 in all the categories; the level is now equivalent to that of two quarters ago. Average Free Rent Month is also the level equivalent to that of two quarters ago, increased simultaneously for all the contract average and the average of contract with free rent.

This result indicates the decrease of long-term free rents offered as an incentive to attract tenants. The new trend is short-period free rents which are offered to avoid payment of double rents when tenants relocate.





### Market Cycle

Figure 8 is a graph plotted by quarter based on vacancy rates on the horizontal axis and 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 shifted to the recovery phase and continued the trend in 2015 too. The vacancy rate is decreasing consistently; however rents agreed in new contracts are growing only slowly. The vacancy level is nearing the point where the sharp increase of rents started in the previous cycle, but it is still too early to expect that the market to follow the pattern in the past considering the growing gap within the market and the economic uncertainty.

## Reference

**Figure 9: Major Building Completions (Q4 2015)**

Name	Floors	Ward	Address	Completion	GFA
Tekko Building	26 + B3	Chiyoda	1-8-2 Marunouchi	Oct 2015	15,465 tsubo
Otemachi Tower / JX Building	22 + B5	Chiyoda	1-1-2 Otemachi	Nov 2015	12,800 tsubo
Sumitomo Fudosan Mita Building	13	Minato	5-37-8 Shiba	Nov 2015	5,400 tsubo
Ueno East Tower	25 + B1	Taito	2-16-1 Higashi Ueno	Dec 2015	N/A

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

**Figure 10: Major Office Relocations (Q4 2015)**

Company	From	To	Month Year	Purpose	Size
Nippon Car Solutions	Seavans N and S <i>Minato Ward</i>	Akihabara UDX <i>Chiyoda Ward</i>	Nov 2015	N/A	1,453 tsubo
Toho Zinc	Marukashiwa Building <i>Chuo Ward</i>	Tekko Building <i>Chiyoda Ward</i>	Jan 2016	Consolidation	393 tsubo
ACCESS	Company-Owned Building, <i>Chiba City</i> Sumitomo Fudosan Sarugakucho Building, <i>Chiyoda Ward</i>	Daito Building <i>Chiyoda Ward</i>	Jan 2016	Better location / Consolidation	600 tsubo
JALUX	I • S Building / Harbor One Building <i>Shinagawa Ward</i>	Shinagawa Season Terrace <i>Minato Ward</i>	Mar 2016	Better location	1,000 tsubo
Pioneer	Company-Owned Building <i>Kawasaki City</i>	7 places in Tokyo including Bunkyo Green Court Center Office, <i>Bunkyo Ward</i>	Mar 2016	Sold the Company- Owned Building	2,045+ tsubo
MX Mobiling	Kasumigaseki Building, <i>Chiyoda Ward</i> Akasaka Garden City, <i>Minato Ward</i>	Toyosu Foresia <i>Koto Ward</i>	Mar 2016	Consolidation	1,000 tsubo

Source: Compiled by Xymax Real Estate Institute based on information released by companies.  
The size of the office space is an estimate.

1 tsubo = approx. 3.3 sqm

Overview of Our Researches					
	Vacancy Rate	New Contract Rent Index	Contract Rent DI	Paying Rent Index	Free Rent Granted (%) & Average Month
Description	Vacant space versus total 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.	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).	Free rent distribution and average period. Free rent is the time lag between the start of the contract and the start of the rent payment.
Main Point	Supply and demand balance in the market	Level of contract rents	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	Tokyo 23 Wards	Tokyo 23 Wards Tokyo Central 3 Wards	Tokyo 23 Wards	Tokyo 23 Wards
Building Size	All	All / Large / Small-Medium	All	All	All
Release	Every Quarter				
Data Source	Independently collected by Xymax. Data of available vacant space and building	Independently collected by Xymax. Data of new contract rents including CAM charge.	Independently collected by Xymax. Data of new contract rents including CAM charge.	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	28,086 buildings	1,227 contracts	1,047 contracts	4,158 contracts	171 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>	<p>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.).</p> <p>2) Estimate a quarterly contract rent by assigning the values of a typical building to the model developed in the preceding step.</p> <p>3) The outcome from the preceding step based on Q1 2010 as the base point (=100), is the New Contract Rent Index.</p> <p>This model show changes in new contract rents after removing property-specific variables.</p>	<p>1) Compare the data of new contract rent per tsubo with that in the 6-month prior period in the same building. Each data was counted separately into three categories: "rent increase", "no change" or "rent decrease"</p> <p>2) Calculate the share of buildings with "rent decrease" and buildings with "rent increase".</p> <p>3) Subtract the share of buildings with "rent decrease" from the share of buildings with "rent increase". This outcome is the Contract Rent Diffusion Index (DI).</p>	<p>1) Calculate the rent per tsubo of each tenant from the data of new and existing lease contracts and memorandums.</p> <p>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.).</p> <p>3) Estimate a quarterly contract rent by assigning the values of a typical building to the model developed in the preceding step.</p> <p>4) The outcome from the preceding step based on Q1 2010 as the base point (=100), is the Paying Rent Index.</p> <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 days.</li> <li>• Ratio of Free Rent Granted The percentage 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 level or closer, but such contracts are excluded from this research.</p>



## Reference

# Xymax REI Research Updates      November 2015 - January 2016

## Office Stock Pyramid 2016      January 29, 2016

- Office Stock Pyramid 2016 was released. In this pyramid chart, building stock in Tokyo is divided into two categories; small and medium buildings and large buildings. The volume of the stock (rentable area, number of buildings) for each age group is compared.
- Small and medium buildings in Tokyo are 28.4 years old on average while large buildings are 22.0 years old. Stock is aging; especially the small and medium buildings.

## Supply of New Office Space 2016 (Tokyo 23 Wards & Osaka City)      December 24, 2015

- The new supply in Tokyo 23 Wards in the next four years is 186,000 tsubo per year on average; expected to increase even further from the ten-year average in 2006-2015. The years 2018 and 2019, in particular, are expected to have a large volume of new supply: over 200,000 tsubo each year.
- The new supply in Osaka City in the next four years is 17,000 tsubo per year on average; roughly a half of the ten-year average in 2006-2015 of 30,000 tsubo per year.

## Electric Power Consumption by Office Tenants (September 2015)      December 9, 2015

- The electric power consumption in the summer of 2015 (July to September) was 38.5 kWh/tsubo; a YoY decrease by 6.1% from 41.0 kWh/tsubo in the summer of 2014.

## Energy Consumption and Energy Cost in Office Buildings (September 2015)      December 9, 2015

- Energy Consumption: The level in 2011 continued. Remained nearly flat.
- Energy Price per Unit: Started to fall in March 2015. Four points down from previous study in June 2015.
- Energy Cost: Decreased following the price drop. Three points down from previous study in June 2015.

## Building Owner Survey 2015      November 26, 2015

- 90% of owners are over 50 years old. 60% have one or two properties
- More than 70% fear the future of the business. Challenges differ depending on owner's age.
- Majority of owners will continue to own the building.

## Work Style & Use of Office Space Survey 2015      November 18, 2015

- Recent progress in information technology enabled work style changes. Mobile working is one of them. If flexible work style continues to expand, will there be any changes in company's office location strategy or any change in the use of office space? Our research encompasses current situations and three-to-five year plans of companies in Japan including obstacles against such plans. This is a summary of the results.

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