

# Office Market Report

Tokyo | Q2 2016

August 3, 2016



## Summary

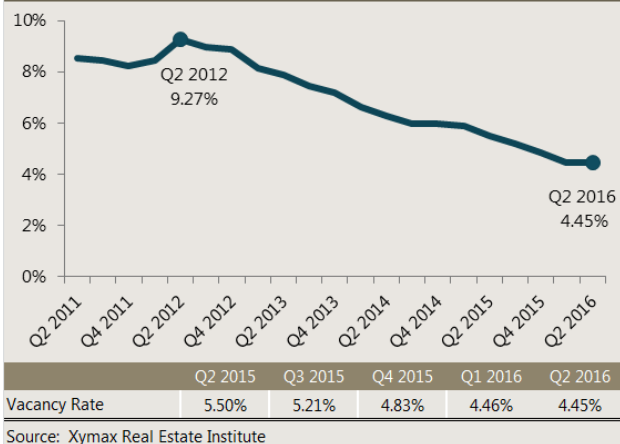
- Vacancy rates and contract rents continued to recover in the Tokyo 23 Wards' office market driven by demand from corporate tenants, but the degree of recovery was small and no significant change was observed. Some companies started to take a careful look at relocation because of the uncertain economic outlook.
- Vacancy rates were 4.45%; decreased by 0.01 points from previous quarter. Available spaces in large buildings completed this year were steadily taken up by tenants, which contributed to the low vacancy rates.
- New Contract Rent Index (level of rents in new lease) was 98; increased by 1 point from previous quarter. Contract Rent DI (ratio of buildings with rent increase minus ratio of buildings with rent decrease) was +17; remained unchanged from previous quarter.
- Paying Rent (level of rents in new lease and those in existing lease combined) was 82; decreased by 2 points from previous quarter.
- Average Free Rent Month was 2.8 months; decreased by 0.4 months from previous quarter. The free rent period is on the decrease since 2012.

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**Figure 1: Vacancy Rate**



### Vacancy

Figure 1 shows changes in vacancy rates in Tokyo 23 Wards since 2011. Vacancy rates in the second quarter of 2016 remained low; decreased by 0.01 point to 4.45%.

Demand for office spaces remained strong as many companies planned to relocate for forward-looking purposes such as expansion or moving to a better location; this combined with the limited supply, the market remained tight. Overall vacancy rates had a slight decrease but the breakdown showed differences between areas: Central Five Wards had a decrease while the periphery 18 wards had an increase. Available spaces in small and medium buildings especially in Shinjuku and Chuo Wards were steadily taken up by tenants.

**Figure 2: New Contract Rent Index**



### New Contract Rent

Figure 2 shows changes in New Contract Rent Index, an index of rent agreed in new lease. The second quarter of 2016 was 98; increased by 1 point from 97 in previous quarter. After the bottom peak at 76 in the second quarter of 2012, the rent continued to increase and recovered the level of six years ago. However, despite the tight market, the rental growth remained slow.

**Figure 3: New Contract Rent Index by Size of Building**

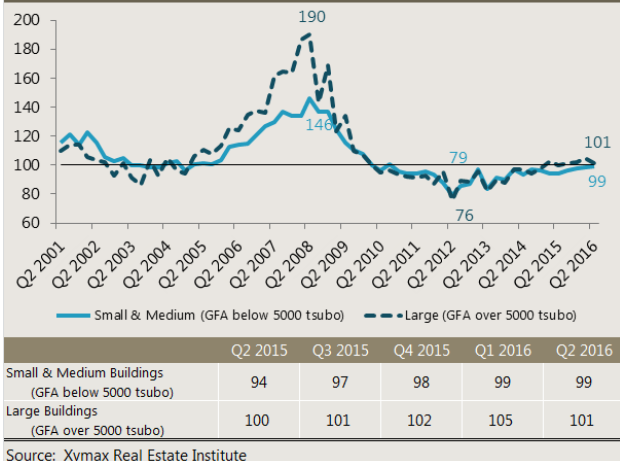
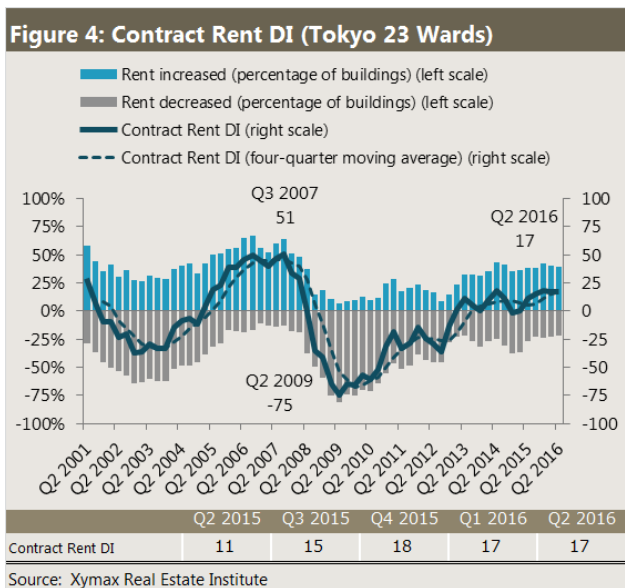


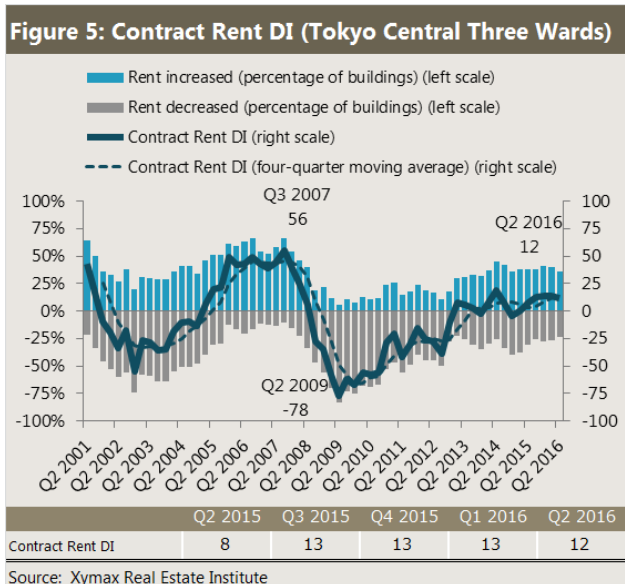
Figure 3 shows changes in New Contract Rent Index by size of buildings. The index of overall Tokyo 23 Wards for small and medium office buildings (gross floor area: below 5,000 tsubo) was 99 while that for large office buildings (gross floor area: over 5,000 tsubo) was 101. Although new large buildings lowered the rent level in some cases to absorb tenants' demand quickly, the overall result continued the modest increase.

This is because, following the reduction of vacant spaces in the overall market, landlords are gradually shifting their pricing strategy and trying to lease the remaining spaces at high rent, but such strategy was not successful in some cases due to the gap between the rents desired by landlords and those desired by tenants.



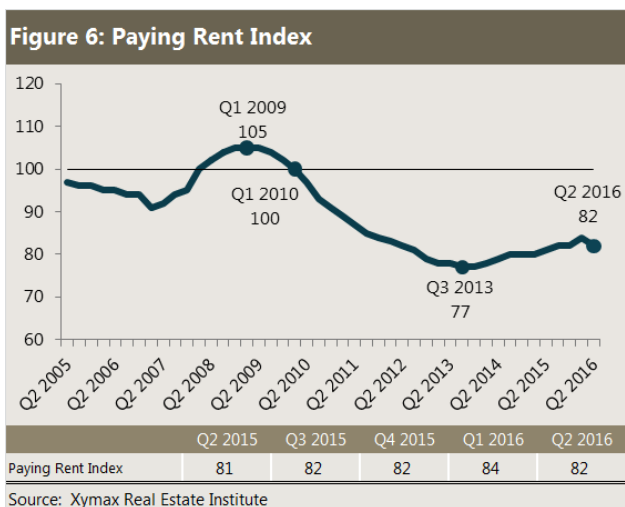
Figures 4 and 5 are changes in Contract Rent Diffusion Index (DI). The second quarter of 2016 remained the same quarter-on-quarter at +17 in Tokyo 23 Wards and decreased by 1 point to +12 in Central Three Wards. The buildings with rent increase surpassed those with rent decrease for five quarters in a row. The DI level remained roughly unchanged since mid-2015.

DI remained above zero in both Tokyo 23 Wards and Central Three Wards. The ratios of buildings were stable for the past 12 months: those with rent increase were approx. 40%, those with rent decrease were approx. 20% and those with no change in rent were approx. 40%. In this quarter, however, the ratio of buildings with no rent change slightly increased in Central Three Wards.



This is because, although the market continued to recover and rental growth spread across Tokyo 23 Wards, the rents of centrally-located large buildings were nearing the upper end and there was no more room for further increase.

Global and domestic economic outlook is becoming more uncertain and more companies are therefore taking a careful look on their future performance. There is also a gap between the rent desired by landlords and those desired by tenants. Some indicators witnessed slowdown of the recovery. To decide whether this is temporary or is actually a turning point, we need to pay close attention to what is going to happen next.

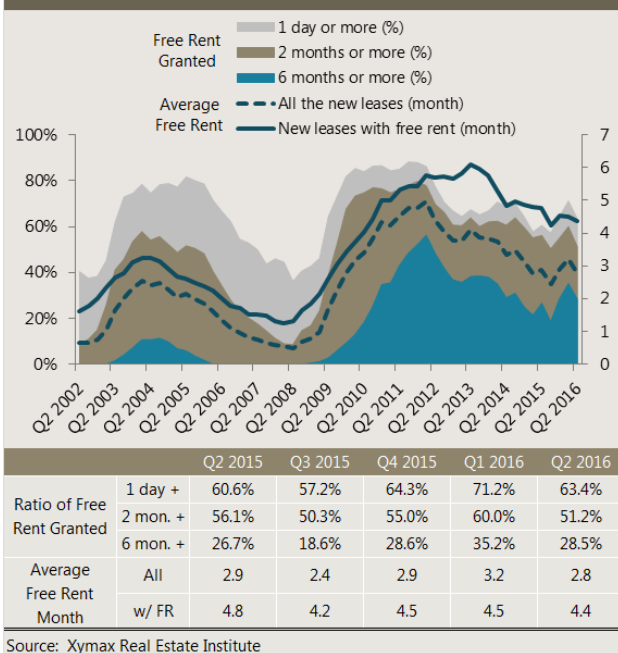


**Paying Rent**

Paying Rent Index, in which new lease rents and existing lease rents are both covered, show changes in income generated from office buildings over time.

Figure 6 shows changes since 2005. Paying Rent Index bottomed in the third quarter of 2013 and continued a modest increase since then. In the second quarter of 2016, the index was 82; decreased by 2 points from previous quarter (based on Q1 2010 = 100).

Figure 7: Free Rent



Source: Xymax Real Estate Institute

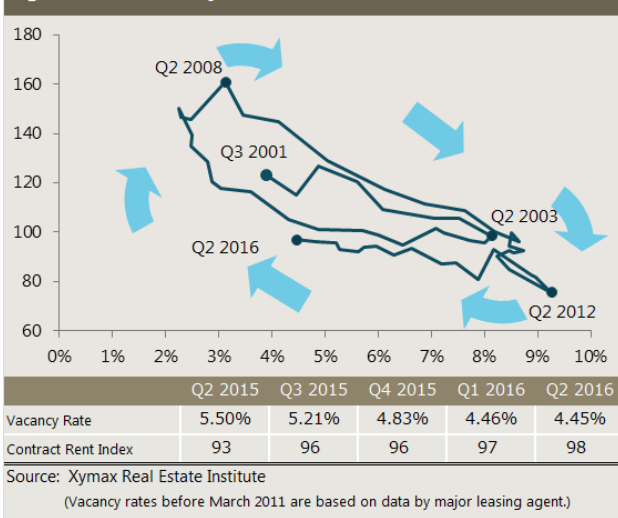
### Free Rent

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

Ratio of Free Rent Granted decreased across the categories in the second quarter of 2016. Average Free Rent Month of all the new leases decreased by 0.4 months to 2.8 months and those of new leases with free rent decreased by 0.1 month to 4.4 months.

The free rent period is on the decrease since 2012.

Figure 8: Market Cycle



Source: Xymax Real Estate Institute

(Vacancy rates before March 2011 are based on data by major leasing agent.)

### 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).

Office space market entered into the recovery phase, which continued into 2016 too. However, vacancy rates decreased only slightly this quarter and rental growth of new lease also remained weak; the plot stayed roughly in the same position as in the previous quarter.



## Reference

Figure 9: Major Building Completions (Q2 2016)

Name	Floors	Ward	Address	Completion	GFA
Otemachi Financial City Grand Cube	31 + B4	Chiyoda	1-9-2 Otemachi	Apr 2016	32,770 tsubo
Nihon Shuzo Toranomon Building (NS Toranomon)	11	Minato	1-6-15 Nishi Shinbashi	Apr 2016	2,167 tsubo
Tokyo Garden Terrace Kioicho Kioi Tower	36 + B2	Chiyoda	1-3 Kioicho	May 2016	24,233 tsubo
PMO Nihonbashi Mitsukoshimae	11	Chuo	3-4-5 Nihonbashi Honcho	May 2016	686 tsubo
DLX Building	12 + B1	Minato	1-13 Nishi Shinbashi	Jun 2016	1,172 tsubo

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

Figure 10: Major Office Relocations (Q2 2016)

Company	From	To	Month Year	Purpose	Size
Recruit Management Solutions	Grand Tokyo South Tower <i>Chiyoda Ward</i>	Gate City Osaki East Tower West Tower, <i>Shinagawa Ward</i>	May 2016	Consolidation	960 tsubo
	Sumitomo Fudosan Marunouchi Building <i>Chiyoda Ward</i>				
	Recruit Annex 1 Building <i>Chuo Ward</i>				
Value Commerce	Ark Hills South Tower <i>Minato Ward</i>	Minami Aoyama Bright Square, <i>Minato Ward</i>	Aug 2016	Expansion	808 tsubo
Marubeni	Marubeni Tokyo Headquarters Building <i>Chiyoda Ward</i>	Tokyo Nihonbashi Tower <i>Chuo Ward</i>	Aug - Sep 2016	Construction of Company-owned Building	9,000 tsubo
Daifuku	Shiba Chitose Building JBP Shiba Building Shiba White Building <i>Minato Ward</i>	Shiodome Shibarikyu Building, <i>Minato Ward</i>	Sep 2016	Consolidation	1,650 tsubo
MS & AD Systems	Mitsui Sumitomo Kaijo Building <i>Suginami Ward</i> Aioi Nissay Dowa Sonpo Sakuragaoka Center <i>Tama City</i> Palace Side Building <i>Chiyoda Ward</i>	Sumitomo Fudosan Shinjuku Garden Tower <i>Shinjuku Ward</i>	Oct 2016	Consolidation	4,000 tsubo
Nomura Research Institute	Marunouchi Kitaguchi Building <i>Chiyoda Ward</i>	Otemachi Financial City Grand Cube, <i>Chiyoda Ward</i>	Dec 2016	BCP	5,300 tsubo

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

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	29,231 buildings	1,058 contracts	910 contracts	3,766 contracts	123 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>	<ol style="list-style-type: none"> <li>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.).</li> <li>2) Estimate a quarterly contract rent by assigning the values of a typical building to the model developed in the preceding step.</li> <li>3) The outcome from the preceding step based on Q1 2010 as the base point (=100), is the New Contract Rent Index.</li> </ol> <p>This model show changes in new contract rents after removing property-specific variables.</p>	<ol style="list-style-type: none"> <li>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: buildings with "rent increase", "no change" or "rent decrease"</li> <li>2) Calculate the share of buildings with "rent decrease" and buildings with "rent increase".</li> <li>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).</li> </ol>	<ol style="list-style-type: none"> <li>1) Calculate the rent per tsubo of each tenant from the data of new and existing lease contracts and memorandums.</li> <li>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.).</li> <li>3) Estimate a quarterly contract rent by assigning the values of a typical building to the model developed in the preceding step.</li> <li>4) The outcome from the preceding step based on Q1 2010 as the base point (=100), is the Paying Rent Index.</li> </ol> <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 April - June 2016

### Electric Power Consumed by Office Tenants (March 2016)

June 3, 2016

- The electric power consumed by office tenants in January, February and March 2016 was 38.9 kWh/tsubo; decreased year-on-year by 2.9 kWh/tsubo or 6.9% from 41.8 kWh/tsubo.

### Energy Consumption and Energy Cost in Office Buildings (March 2016)

June 3, 2016

- Energy Consumption: 2.8% down year-on-year; a record low, slightly below the level continued since 2011.
- Energy Price per Unit: 5 points down from previous study (Dec. 2015). The price started to fall in March 2015.
- Energy Cost: 6 points down from previous study (Dec. 2015), decreased in line with the consumption and price.

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