Office Market Report

Tokyo | Q3 2016

November 2, 2016

Summary

- A modest recovery of the vacancy rate and contract rent continued in the Tokyo 23 Wards' office market, driven by the stable demand from corporate tenants. The tenant's demand expanded to include periphery areas because of the limited availability in the central part of Tokyo.
- The vacancy rate was 4.08%; decreased by 0.37 points from previous quarter. The vacancy level remained low because only a few large buildings were completed this quarter.
- New Contract Rent Index (the level of new lease rent) was 104; increased by 6 points from previous quarter. Contract Rent DI (calculated by subtracting the ratio of buildings with a rent decrease from the ratio of buildings with a rent increase) was +21; increased by 4 points.
- Paying Rent (the level of new lease rent and that of existing lease rent combined) was 84; increased by 2 points from previous quarter.
- Average Free Rent Month was 3.1 months; increased by 0.3 months from previous quarter. Although in a general view, the free rent period seems to be shorter, the average period actually resulted in an increase influenced by some cases of long free rent of longtime vacant buildings in the periphery area.

Figure 1: Vacancy Rate

	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016
Vacancy Rate	5.21%	4.83%	4.46%	4.45%	4.08%

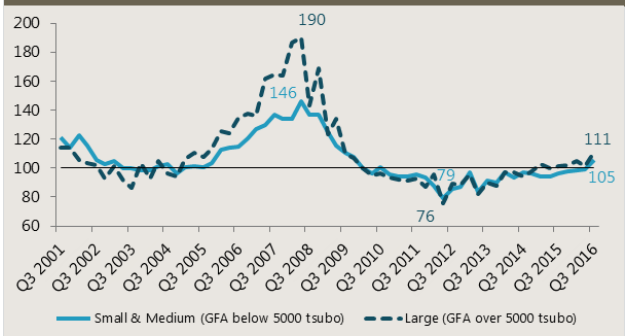
Source: Xymax Real Estate Institute

Figure 2: New Contract Rent Index

	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016
New Contract Rent Index	96	96	97	98	104

Source: Xymax Real Estate Institute

Figure 3: New Contract Rent Index by Size of Building



	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016
Small & Medium Buildings (GFA below 5000 tsubo)	97	98	99	99	105
Large Buildings (GFA over 5000 tsubo)	101	102	105	101	111

Source: Xymax Real Estate Institute

Vacancy

Figure 1 shows changes in vacancy rates in Tokyo 23 Wards since 2011. The vacancy rate in the third quarter of 2016 decreased by 0.37 points quarter-on-quarter to 4.08%. The rates kept decreasing since the third quarter of 2012.

The office space market remained tight since many companies planned relocation for the purpose of expanding the office size or moving to a better location. The analysis by region shows that the decrease in vacancy was small in the Central Five Wards, but it was large in the periphery 18 wards. In particular, there were cases where some tenants decided to look for a space in non-central areas because they had difficulty finding a large space in the central area.

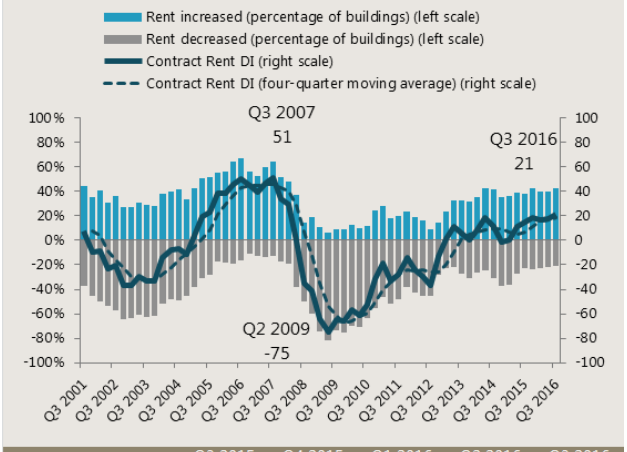
New Contract Rent

Figure 2 shows changes in New Contract Rent Index, which is the index of the new lease rent. The third quarter of 2016 was 104; increased by 6 points from 98 in the previous quarter. After bottoming in the second quarter of 2012 at 76, the rents continued to increase and recovered the level of six years ago. The market is tight and rents are growing.

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 105 while that for large office buildings (gross floor area: over 5,000 tsubo) was 111; both increased quarter-on-quarter. The rents increased thanks to the demand to move to a better area or to a larger space to consolidate separately-located offices.

The modest increase of rents continued, but the rents of high-grade buildings in the central area seemed to have hit the ceiling. The rents in the overall market increased because of the rental growth in the periphery markets and small and medium existing buildings; the high level of rents like those in 2007 are only rarely seen.

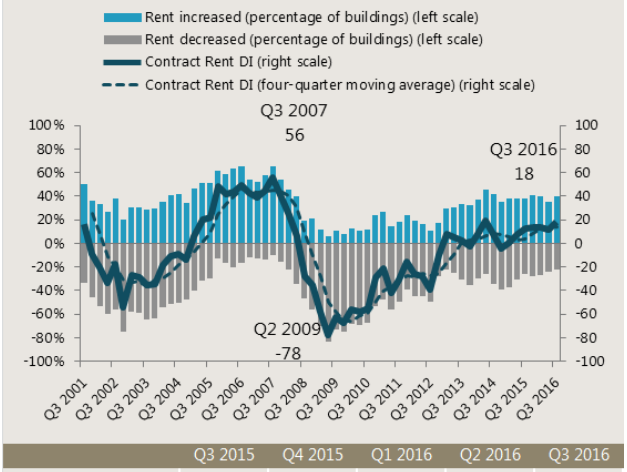
Figure 4: Contract Rent DI (Tokyo 23 Wards)



	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016
Contract Rent DI	15	18	17	17	21

Source: Xymax Real Estate Institute

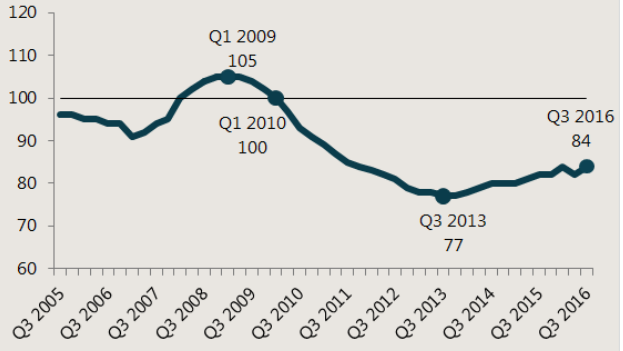
Figure 5: Contract Rent DI (Tokyo Central Three Wards)



	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016
Contract Rent DI	13	13	13	12	18

Source: Xymax Real Estate Institute

Figure 6: Paying Rent Index



	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016
Paying Rent Index	82	82	84	82	84

Source: Xymax Real Estate Institute

Figures 4 and 5 are changes in Contract Rent Diffusion Index (DI). The DI in the third quarter of 2016 increased by 4 points to +21 in Tokyo 23 Wards and increased by 6 points to +18 in Central Three Wards. The number of buildings with a rent increase surpassed those with a rent decrease for six consecutive quarters, indicating the increase of new contract rents.

The breakdown of Contract Rent DI is as follows: when a new lease is signed, 40% of the buildings had a rent increase; 20% had a decrease; and 40% had no change. The ratio of the buildings with a rent decrease is decreasing but the pace slowed in the latest 12 months. Central Three Wards had a greater increase in the ratio of the buildings with a rent increase by 5 points compared to 3 points for that in Tokyo 23 Wards.

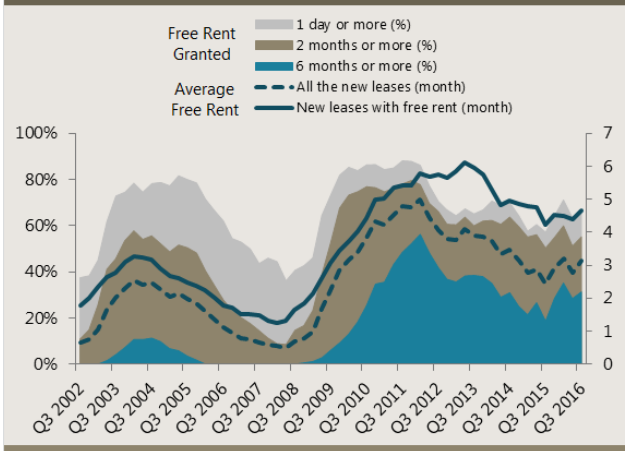
In some cases, more than one potential tenant submitted an application to lease a space in a recently-constructed building in the central area and the rent agreed for such lease was often higher than the landlord had expected. In other cases, the landlord tried to keep the rent per tsubo of longtime vacant space and instead offered a long period of free rent to attract potential tenants.

The consumer spending and corporate capital spending remain weak. However, the demand for office space is strong reflecting the tight job market. Some particular demands include the staffing companies establishing a new sales office or moving to a better location and the gaming and web contents companies having a new development base to start a new service.

Paying Rent

Figure 6 shows changes in Paying Rent Index, in which new lease rents and existing lease rents are both covered. Paying Rent Index in the third quarter of 2016 was 84; increased by 2 points from the previous quarter and continued the modest growth started since the third quarter of 2013. The rents of existing tenants also increased in some cases.

Figure 7: Free Rent



		Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016
Ratio of Free Rent Granted	1 day +	57.2%	64.3%	71.2%	63.4%	67.2%
	2 mon. +	50.3%	55.0%	60.0%	51.2%	55.2%
	6 mon. +	18.6%	28.6%	35.2%	28.5%	31.3%
Average Free Rent Month	All	2.4	2.9	3.2	2.8	3.1
	w/ FR	4.2	4.5	4.5	4.4	4.7

Source: Xymax Real Estate Institute

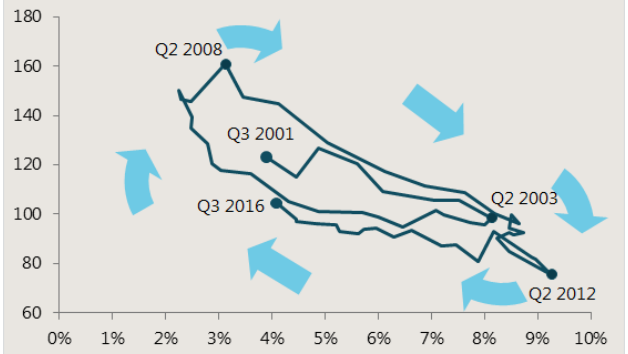
Free Rent

Figure 7 shows changes in the ratio of new leases with free rent 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 increased across the categories in the third quarter of 2016. Average Free Rent Month of all the new leases increased by 0.3 months to 3.1 months and those of new leases with free rent increased by 0.3 months to 4.7 months.

In a general view, the free rent period seemed to be shortening; however, both the ratio and average period actually increased this quarter. This is probably because of the influence of the long period of free rent given to longtime vacant spaces.

Figure 8: Market Cycle



	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016
Vacancy Rate	5.21%	4.83%	4.46%	4.45%	4.08%
Contract Rent Index	96	96	97	98	104

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).

The office space market entered the recovery phase in 2013 and stayed there in 2016 too. The second quarter of 2016 ended with only a marginal change, but the third quarter had a growth of the new contract rent and the line moved slightly to upper left, indicating a continued market improvement.

Reference

Figure 9: Major Building Completions (Q3 2016)

Name	Floors	Ward	Address	Completion	GFA
Sumitomo Fudosan Shinbashi Building	10	Minato	6-9-8 Shinbashi	Jul 2016	1,709 tsubo
JEBL Akihabara Square	13 + B1	Chiyoda	76 Kanda Neribeicho	Aug 2016	2,029 tsubo
Okura House	12 + B3	Chuo	2- 6 -12 Ginza	Aug 2016	1,696 tsubo
Success Ginza 7-chome Building	12 + B2	Chuo	7-13-10 Ginza	Aug 2016	1,244 tsubo

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

Figure 10: Major Office Relocations (Q3 2016)

Company	From	To	Month Year	Purpose	Size
Japan Real Estate Institute	Kangin Fujiya Building *Minato Ward*	Shiodome Shibarikyu Building, *Minato Ward*	Jul 2016	Redevelopment	660 tsubo
Onward Trading Co., Ltd.	Onward Shoji Building *Koto Ward*	ACOM Iidabashi Building *Chiyoda Ward*	Jul 2016	Purchased owner-occupied building	1,123 tsubo
Accordia Golf Co., Ltd.	Shibuya Cross Tower *Shibuya Ward*	Shinagawa Seaside Park Tower, *Shinagawa Ward*	Oct 2016	Consolidation	657 tsubo
Oriental Consultants Global Co., Ltd.	Sumitomo Fudosan Nishi Shinjuku Building 6 *Shibuya Ward*	Tokyo Opera City Building *Shinjuku Ward*	Oct 2016	Expansion	608 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	29,628 buildings	1,253 contracts	956 contracts	4,177 contracts	134 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. 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.	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 a quarterly contract rent by assigning the values of a typical building to the model developed in the preceding step. 3) The outcome from the preceding step based on Q1 2010 as the base point (=100), is the New Contract Rent Index. This model show changes in new contract rents after removing property-specific variables.	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" 2) Calculate the share of buildings with "rent decrease" and buildings with "rent increase". 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).	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 outcome from the preceding step based on Q1 2010 as the base point (=100), is the Paying Rent Index. With this method, influences from replacement of sample data and deterioration of buildings over age are removed from the result.	• Free Rent Period The period between the start of the contract and the start of the rent, shown in days. • 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) • 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. 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.

Appendix

Xymax REI Research Updates July - September 2016

Economic Value of Repair September 28, 2016

- The repair record and rental data accumulated by Xymax are used in this statistical analysis.
- The analysis revealed that the new lease rent is 3%-7% higher if the buildings were properly prepared and repaired consistently for particular types of repairs.
- Repairs are the important element in real estate management because the planned and consistent repairs can not only improve the problems and fix the broken items but also reduce the risk of deterioration in the future and give economic benefit.

Office Space per Person 2016 September 21, 2016

- Office Space per Person in Tokyo 23 Wards: 3.80 tsubo, a record low since this study started.
- Office Rent per Person in Tokyo 23 Wards: JPY64,697 per month (incl. CAM charge)
- These results were likely to have been influenced by the increase in the number of office workers following the recovery in corporate earnings.

Electric Power Consumed by Office Tenants (June 2016) September 7, 2016

- The average consumption in the April-June 2016 quarter was 32.9 kWh/tsubo; a decrease of 1.2 kWh/tsubo or 3.5% from 34.1 kWh/tsubo in the same quarter previous year.

Energy Consumption and Energy Cost in Office Building (June 2016) September 7, 2016

- Energy Consumption
  Remained unchanged from the previous quarter (March 2016).
- Energy Price per Unit
  7 points down from previous quarter (March 2016). Started to fall in March 2015.
- Energy Cost
  5 points down from previous quarter (March 2016). Decreasing in line with the falling consumption and price.

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