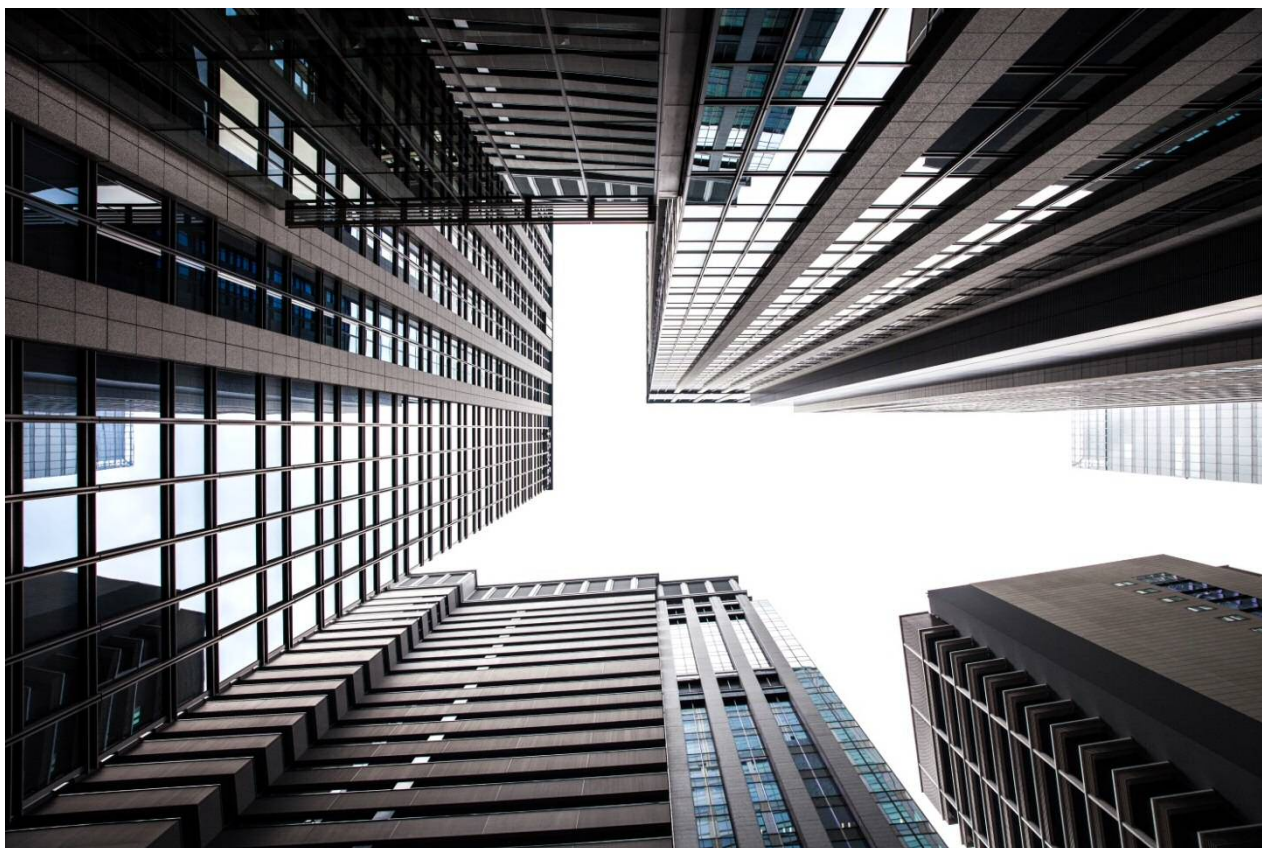


Office Market Report

Tokyo | Q3 2017

November 1, 2017



Summary

(1 tsubo = 3.3 sqm)

- In the September 2017 quarter, the Tokyo 23 Wards' office market remained tight with the low vacancy rate at the 3% level. The new contract rent turned up again after a drop in the previous quarter.
- **Vacancy Rate** was 3.28%, a decrease by 0.38 points. **Decrease in Vacant Space** was 241,000 tsubo while **Increase** was 189,000 tsubo; the decrease was larger than the increase. **Vacancy Turnover Ratio** (the ratio of vacant space leased up during the quarter to all the vacancy stock) is moving upward.
- **New Contract Rent Index** (the level of new lease rent) was 109, an increase by 5 points. **Contract Rent Diffusion Index**, calculated by subtracting the percentage of buildings with a rent decrease from the percentage of buildings with a rent increase, was +13, an increase by 7 points.
- **Paying Rent Index** (the level of new lease rent and the level of existing lease rent combined) was 92, an increase by 1 point.
- The free rent period is becoming shorter. **Average Free Rent Month of Lease with Free Rent** was 3.3 months, a decrease by 0.4 months.



Vacancy

Figure 1 shows changes in **Vacancy Rate** in Tokyo 23 Wards since 2011. The vacancy rate in the third quarter of 2017 decreased by 0.38 points quarter-on-quarter to 3.28%. It has been decreasing since the third quarter of 2012.

Available space is disappearing in the entire market. Office spaces with good lease terms are taken by new tenants soon after they become available. Such spaces are often taken by other tenants in the building and never exposed to the market, indicating that the strong demand for office space continued.

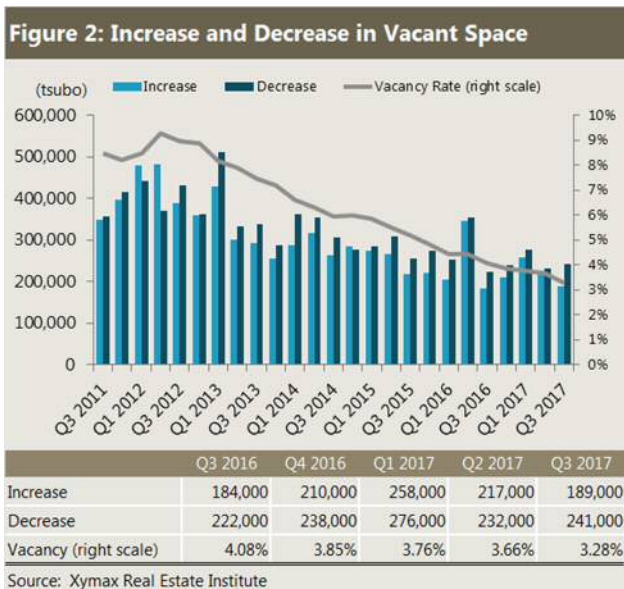


Figure 2 shows a quarterly increase and a quarterly decrease in vacant space (**Increase and Decrease in Vacant Space**). The increase was 189,000 tsubo and the decrease was 241,000 tsubo; the decrease surpassed the increase for 11 consecutive quarters since the first quarter of 2015, contributing to the constant decrease in vacancy rate.

The variance between the increase and the decrease is larger this quarter than that in the previous quarter. This is partly because some tenants relocated to large buildings but the space they formerly occupied was immediately taken by a new tenant and never counted as vacant space.

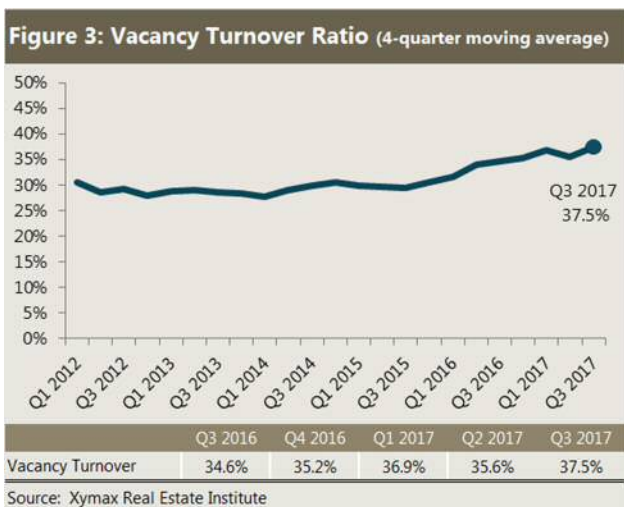


Figure 3 shows **Vacancy Turnover Ratio (four-quarter moving average)**, which is the ratio of the vacant spaces leased to tenants during the quarter to all the vacant office stock (vacancy at the start of the quarter + vacancy added during the quarter).

The ratio in this quarter was 37.5%, a slight increase quarter-on-quarter. A modest increase continued, indicating that vacant spaces in the market are steadily leased up by new tenants.

Figure 4: New Contract Rent Index



New Contract Rent

Figure 4 shows changes in **New Contract Rent Index** (Tokyo 23 Wards), which is the index of the level of new lease rent. The index for the third quarter of 2017 was 109, an increase by 5 points from 104 in the previous quarter. It moved upward again after having decreased for the first time in nine quarters in the previous quarter.

Figure 5: New Contract Rent Index by Size of Building



Figure 5 shows changes in **New Contract Rent Index by Size of Buildings**. The index for small and medium buildings (gross floor area: below 5,000 tsubo) was 109, an increase by 6 points, and the index for large buildings (gross floor area: over 5,000 tsubo) was 111, an increase by 4 points.

The index had decreased for both sizes in the previous quarter, but they increased this quarter and continued the upward move started in the third quarter of 2012.

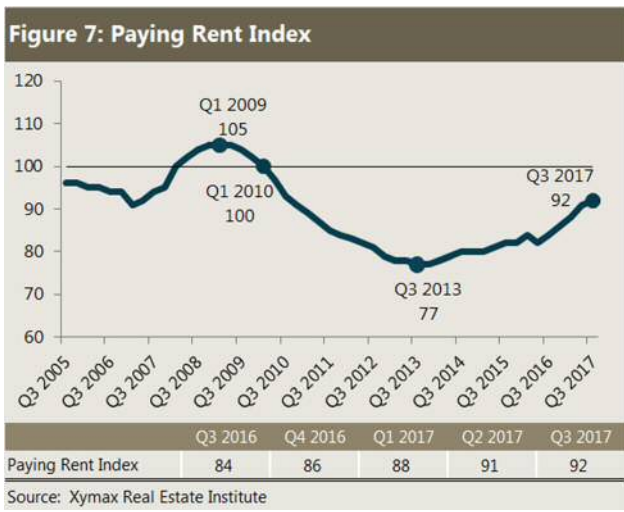
Figure 6: Contract Rent DI (Tokyo 23 Wards)



Figure 6 shows changes in **Contract Rent Diffusion Index (DI)** (Tokyo 23 Wards). The figure increased by 7 points this quarter to +13. The above-zero DI means the buildings with a rent increase continued to exceed the buildings with a rent decrease. This quarter marked the tenth consecutive above-zero DI.

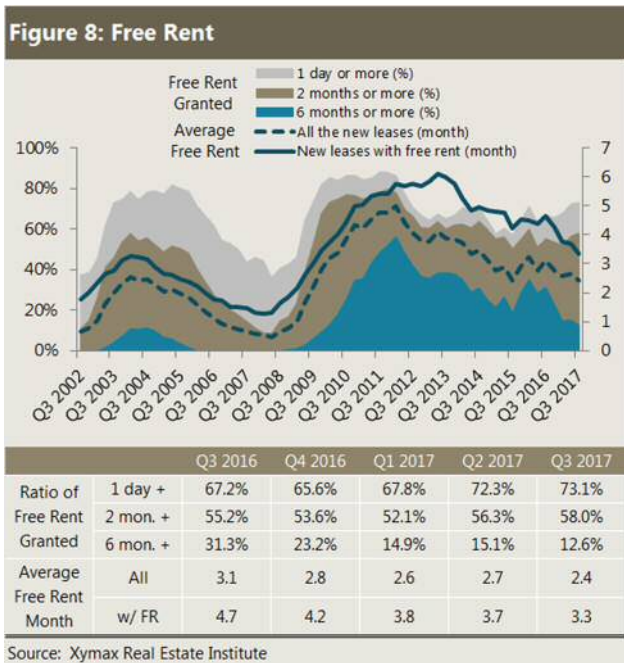
New Contract Rent DI had remained at a single-digit figure for two consecutive quarters in the second quarter of 2017, influenced by the decrease in New Contract Rent Index, which could be signs of slowdown in rental growth. This quarter, however, the DI turned up again and the upward momentum returned and continued.

Since available spaces are now limited in central Tokyo, tenants are starting to look for office space in further areas. This has increased the rent in the periphery 18 wards too.



Paying Rent

Figure 7 shows changes in **Paying Rent Index** (Tokyo 23 Wards), in which new lease rents and existing lease rents are both covered. The index in the third quarter of 2017 was 92, an increase by 1 point from the previous quarter. It continued the modest growth started in the third quarter of 2013. The paying rent increased, contributed by both the increase in rent of new lease and the increase in rent of existing lease.



Free Rent

Figure 8 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**). The average free rent of all the new leases was 2.4 months, a decrease by 0.3 months.

The free rent period is becoming shorter and shorter. The ratio of long free rent period (six months or more) decreased year-on-year to 12.6% from 31.3% in the third quarter of 2016. Such a long free rent period is almost no longer seen except for buildings that are having hard time finding new tenants or buildings that are new completions.



Market Cycle

Figure 9 is a graph plotted by quarter with vacancy rates on the horizontal axis and the New Contract Rent Index on the vertical axis. It 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 market entered the recovery phase in 2013 and remained there in 2017. This quarter, the plot moved slightly to the upper left because the vacancy rate decreased and the rent increased.

Reference

Figure 10: Major Building Completions (Q3 2017)

Name	Floors Above Ground / Below Ground	Ward	Address	Completion	Gross Floor Area (tsubo)
Hulic Kamata Building	8 / 1	Ota	5-17-2 Kamata	Jul 2017	705
Akasaka Intercity AIR	38 / 3	Minato	1-8-1 Akasaka	Aug 2017	24,806
Sumitomo Fudosan Tamachi Building	12 / 0	Minato	3-12-7 Shibaura	Aug 2017	2,154
Empire Building	10 / 1	Chuo	2-23-1 Hatchobori	Sep 2017	2,589
Jingumae Tower Building	23 / 3	Shibuya	1-6 Jingumae	Sep 2017	6,941
S-GATE Akihabara	8 / 0	Chiyoda	2-4-6 Kanda	Sep 2017	508

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

Figure 11: Major Office Relocations (Q3 2017)

Company	From	To	Month Year	Purpose	Size (tsubo)
Dentsu Public Relations	Hamarikyu Mitsui Building <i>Chuo Ward</i>	Shiodome City Center <i>Minato Ward</i>	Sep 2017	Better Efficiency	843
Glaxo SmithKline Group	GSK Building <i>Shibuya Ward</i>	Akasaka Intercity AIR <i>Minato Ward</i>	Oct 2017	N/A	3,500
Haseko Reform Haseko Smile Community	Ichiboshi Shiba Koen Building, <i>Minato Ward</i> Hokkai Shiba Building <i>Minato Ward</i>	Haseko Shiba 2 Building <i>Minato Ward</i>	Sep 2018	Consolidation	2,808
Itoki	Urbannet Irifune Building <i>Chuo Ward</i> Sumitomo Fudosan Tsukiji Building, <i>Chuo Ward</i> Other buildings	Nihonbashi 2-chome Category I Urban Area Redevelopment Project (District C) (temporary name), <i>Chuo Ward</i>	Autumn 2018	Consolidation	2,000
Mitsubishi Motors	Daiichi Tamachi Building <i>Minato Ward</i> Shibaura Lune Site Tower <i>Minato Ward</i>	Tamachi Station Tower S <i>Minato Ward</i>	Dec 2018	Consolidation	6,552

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

Overview of Researches				
	Vacancy Rate	Increase and Decrease in Vacant Space	Vacancy Turnover Ratio	New Contract Rent Index
Description	Vacant 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	Office Building	Office Building	Office Building
Market	Tokyo 23 Wards	Tokyo 23 Wards	Tokyo 23 Wards	Tokyo 23 Wards
Building Size	All	All	All	All / Large / Small & Medium
Release	Every Quarter	Every Quarter	Every Quarter	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	31,300 buildings	22,711 contracts	22,711 contracts	769 contracts
How to Calculate	<ul style="list-style-type: none"> • 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. <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>	<ul style="list-style-type: none"> • Increase in volume of vacant space <ol style="list-style-type: none"> a. Space in existing buildings formerly occupied by tenants b. Total rentable area of new completions • Decrease in volume of vacant space <ol style="list-style-type: none"> 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 <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>	<ul style="list-style-type: none"> • 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" 	<ol style="list-style-type: none"> 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) The New Contract Rent Index is the rent estimated in the preceding step based on Q1 2010 as the base point (=100). <p>This model shows changes in new contract rents after removing property-specific variables.</p>

	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	Office Building	Office Building
Market	Tokyo 23 Wards / Tokyo Central 3 Wards	Tokyo 23 Wards	Tokyo 23 Wards
Building Size	All	All	All
Release	Every Quarter	Every Quarter	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	1,312 contracts	3,686 contracts	119 contracts
How to Calculate	<ol style="list-style-type: none"> 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). 	<ol style="list-style-type: none"> 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). <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"> • Free Rent Period The period between the start of the contract and the start of the rent, shown in number of days. • 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. • Average Free Rent (Month) of Contracts with Free Rent The simple average of the free rent period of lease contracts with free rent. <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 or closer level, but such contracts are excluded from this research.</p>

Appendix

Xymax REI Research Updates July – October 2017

Building Owner Survey 2017 October 25, 2017 (the report is available in Japanese)

- Xymax Real Estate Institute surveyed the owners of small and medium buildings in central Tokyo and Osaka city. In the questionnaires and interviews, the owners were asked about the current situation of their tenant-occupied buildings, future outlook and whether they have intention to continue the business.
- The survey discovered the current situation and challenges of the owners in operating tenant-occupied buildings as well as a variety of ideas on the business for the near future.

Office Space per Person 2017 October 18, 2017

- Office space per person of Tokyo 23 Wards in 2017 was 3.81 tsubo for all the tenants.
- It was 3.94 tsubo for new tenants, exceeding 3.81 tsubo for existing tenants.

Survey on Opening and Closing Stores 2017 September 29, 2017 (the report is available in Japanese)

- Opening and closing stores are a core part of business and the most important real estate strategy for store operators. However, quantitative survey and analysis of such field encompassing different types of retailers rarely exist.
- Xymax Real Estate Institute, together with the research team of Professor Yukio Komatsu, Department of Architecture at Waseda University, surveyed and interviewed retail companies that are operating multiple stores about opening and closing stores and made a summary of the survey results.

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