

Office Market Report

Tokyo | Q4 2017

February 7, 2018

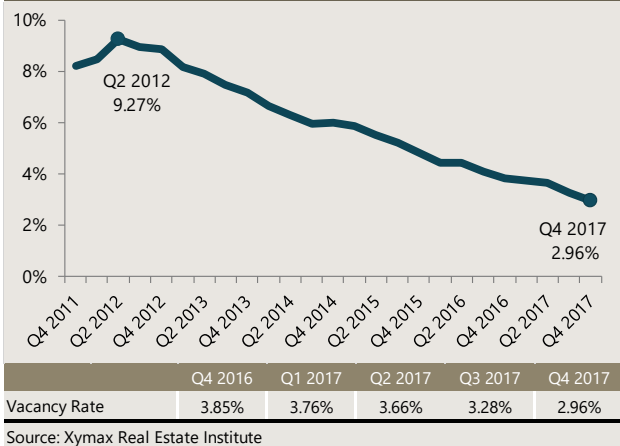


Summary

(1 tsubo = 3.3 sqm)

- In the December quarter, the Tokyo 23 Wards' office market remained tight with the vacancy rate dropping below 3% to the 2% level. Some of the new contract rent indicators showed a slowdown, requiring attention to future developments.
- The **vacancy rate** was 2.96%, down 0.32 points. The **Decrease in Vacant Space** was 197,000 tsubo, while the **Increase** was 163,000 tsubo; decrease exceeded increase. The **Vacancy Turnover Ratio** (the ratio of vacant space leased during the quarter to all the vacancy stock) is rising.
- The **New Contract Rent Index** (the level of new lease rent) was 106, down 3 points. The **Contract Rent Diffusion Index**, calculated by subtracting the percentage of buildings with a rent decrease from the percentage of buildings with a rent increase, rose by 4 points over the quarter to +17.
- The **Paying Rent Index** (the level of new lease rent and the level of existing lease rent combined) dropped 3 points to 89.
- The **Average Free Rent Month of Lease with Free Rent** was 3.6 months, an increase by 0.3 months. Although the Ratio of Free Rent Granted increased in all segments, the percentage of free rent for 6 months or more was small.

Figure 1: Vacancy Rate



Vacancy

Figure 1 shows the **vacancy rate** in the Tokyo 23 Wards since 2011. The vacancy rate in Q4 2017 dropped by 0.32 points quarter-on-quarter to 2.96%. The rate, which has been declining since the Q3 2012, has now dropped below 3% to the 2% level.

Vacancies of a reasonable size and price range for companies are quickly filled, resulting in scarce available space in the entire market. Many office spaces that do become available 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: Increase and Decrease in Vacant Space

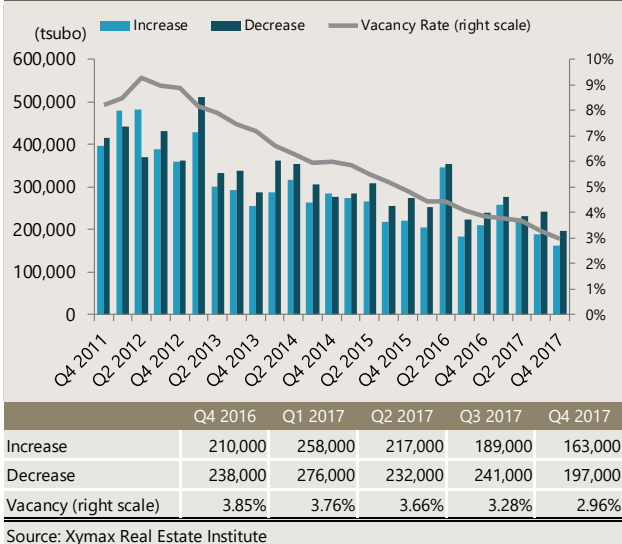


Figure 2 shows the quarterly increase and decrease in vacant space (**Increase and Decrease in Vacant Space**). The increase was 163,000 tsubo and the decrease was 197,000 tsubo; decrease exceeded increase for 12 consecutive quarters since Q1 2015, contributing to the constant decline in the vacancy rate.

The volume of both the increase and decrease in Q4 2017 was smaller than the volume in the previous quarter. This is due to the fewer vacant spaces in the market.

Figure 3: Vacancy Turnover Rate (4-quarter moving average)

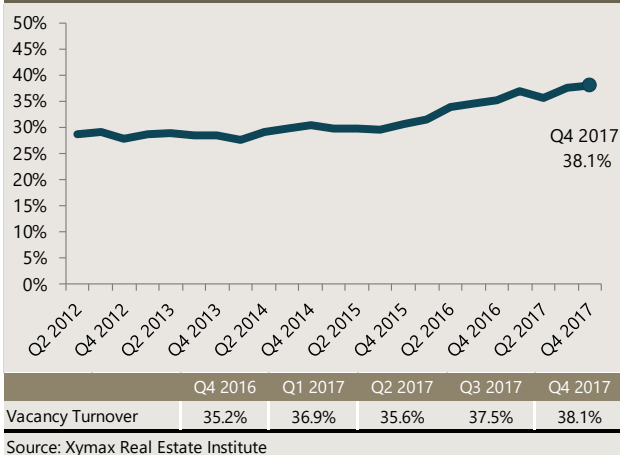


Figure 3 shows the **Vacancy Turnover Ratio** (four-quarter moving average), which is the ratio of vacant spaces leased to tenants during the quarter to all the vacant office stock (vacancy at the start of the quarter + vacancy added during the quarter).

The ratio in Q4 2017 was 38.1%, a slight rise quarter-on-quarter. A modest rise continued, indicating that vacant spaces in the market continue to be steadily leased up by new tenants.

Figure 4: New Contract Rent Index



New Contract Rent

Figure 4 shows the **New Contract Rent Index** (Tokyo 23 Wards), the index of new lease rent levels. The index for Q4 2017 was 106, a 3-point drop from 109 in the previous quarter. New contract rent has been fluctuating up and down since 2017.

Figure 5 shows the **New Contract Rent Index by Size of Building**. The index for small & medium buildings with a gross floor area (GFA) of less than 5,000 tsubo was 106 and that for large buildings with GFA of 5,000 tsubo or more was 108, both a 3-point drop. New contract rent was weak in all building sizes.

Figure 5: New Contract Rent Index by Size of Building



Figure 6 is the **Contract Rent Diffusion Index (DI)** (Tokyo 23 Wards), which shows the direction of changes in new lease rents. The DI in Q4 2017 rose 4 points over the quarter to +17. An above-zero DI means the number of buildings with a rent increase exceeded those with a rent decrease. Q4 2017 marked the eleventh consecutive above-zero DI.

The New Contract Rent Index dropped even in a tight market with hardly any vacant offices. While the rising trend of lease rents has been long-standing, the level of rent has remained low, with vacant offices at high price ranges having difficulty in finding tenants. There has been no surge in rent as in the “fund bubble” era. On the other hand, the fact that Contract Rent DI, which is based on the number of increases and decreases in rent, remains above zero indicates a continued mild rent increase in the market as a whole. Some tenants intend to relocate after determining the impact of future mass supply. While there are currently few factors that would trigger a significant drop in rent, attention should be paid to future developments to determine whether the long rent increase phase is about to peak out.

Figure 6: Contract Rent DI (Tokyo 23 Wards)

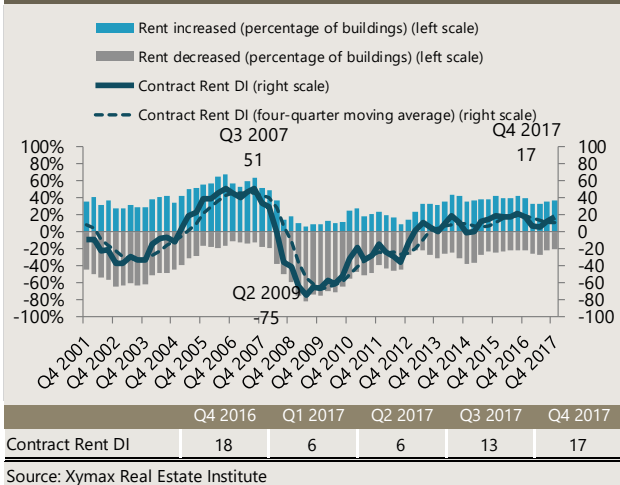
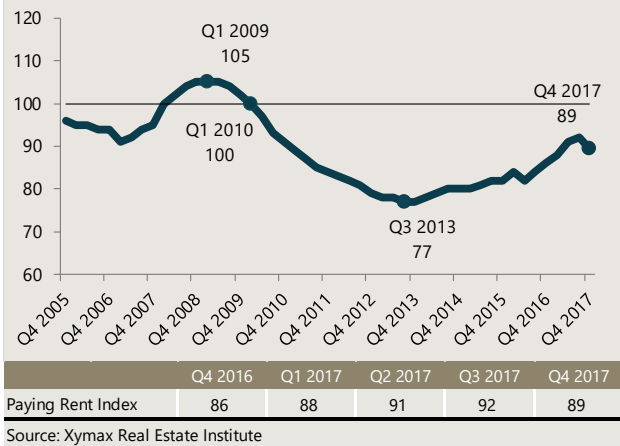


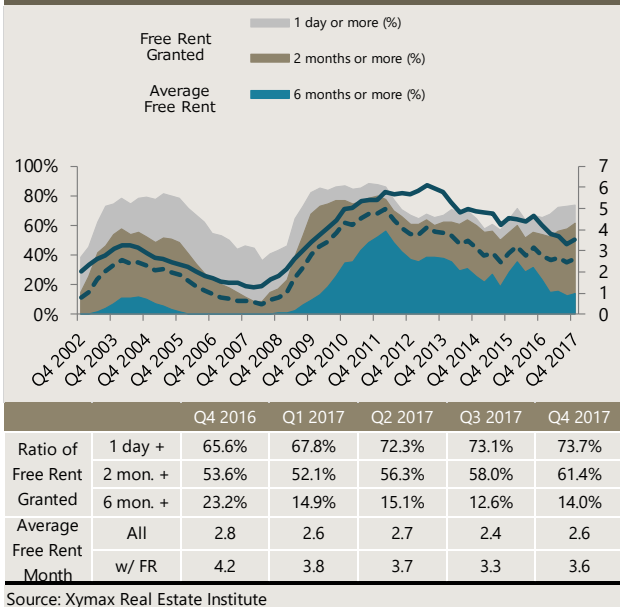
Figure 7: Paying Rent Index



Paying Rent

Figure 7 shows changes in the **Paying Rent Index** (Tokyo 23 Wards), which covers both new lease rents and existing lease rents. The index in the fourth quarter of 2017 was 89, a drop of 3 points from the previous quarter. It has remained on a mild rising trend since the third quarter of 2013.

Figure 8: Free Rent

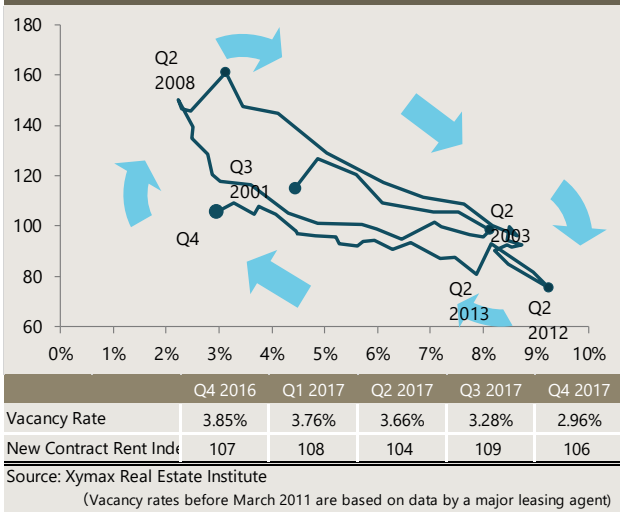


Free Rent

Figure 8 shows changes in the ratio of new lease contracts with free rent to all new lease contracts (**Ratio of Free Rent Granted**) and changes in the average free rent period (**Average Free Rent Month**). The average number of months with free rent of all new lease contracts was 2.6 months for the quarter under review, an increase of 0.2 months quarter-on-quarter, while the average number of months of contracts with free rent was 3.6 months, an increase of 0.3 months.

Although the Ratio of Free Rent Granted rose in all segments, the percentage of free rent for six months or more is small.

Figure 9: Market Cycle



Market Cycle

Figure 9 plots vacancy rates on the horizontal axis and the New Contract Rent Index on the vertical axis on a quarterly basis. It shows the cyclicity of the market, with the chart trending to the lower right in 2001 (vacancy up, rent down), remaining static in 2003–2004, then trending to the upper left in 2005 (vacancy down, rent up) and to the lower right again in 2008 (vacancy up, rent down).

The market entered a recovery phase in 2013, with the trend continuing in 2017. During the quarter under review, the chart moved slightly to the lower left due to a drop in vacancy rates and a rise in rent.

Reference

Figure 10: Major Building Completions (Q4 2017)

Name	Floors Above Ground / Below Ground	Ward	Address	Completion	Leasable space (tsubo)
Ueno Frontier Tower	23 / 2	Taito	3-24-6 Ueno	Oct 2017	3,524
Meguro Central Square	27 / 2	Shinagawa	3-1-1 Kamiosaki	Nov 2017	12,403
BIZCORE Jimbocho	9 / 0	Chiyoda	-9-2 Kanda Ogawach	Nov 2017	1,692
Yamate Shinjuku Bld.g	12 / 2	Shinjuku	1-19-6 Nishi-Shinjuku	Nov 2017	1,511

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

Figure 11: Major Office Relocations (Q4 2017)

Company	From	To	Month Year	Purpose	Size (tsubo)
Toyota Modellista International	Group company building <i>Suginami Ward</i>	Chofu Center Building <i>Chofu City</i>	Nov 2017	Business expansion	570
Meitec	Sumitomo Fudosan Aoyama Building West <i>Minato Ward</i>	ORIX Ueno 1-chome Building <i>Taito Ward</i>	Dec 2017	N/A	1,176
Anderson Mori & Tomotsune	Akasaka K TOWER <i>Minato Ward</i>	Otemachi Park Building <i>Chiyoda Ward</i>	May 2018	Business expansion	3,591
Universal Music	Universal Music Head Office Building <i>Minato Ward</i>	Jingumae Tower Building <i>Shibuya Ward</i>	Jul – Sep 2018	Office environment improvement	1,800
Mitsubishi Materials	Keidanren Kaikan <i>Chiyoda Ward</i>	Marunouchi Nijubashi Building <i>Chiyoda Ward</i>	Mar 2019	Better efficiency	2,360
Mixi	Sumitomo Fudosan Shibuya First Tower, NBF Shibuya East, Next site Shibuya Building <i>Shibuya Ward</i>	Shibuya Scramble Square (East bldg.) <i>Shibuya Ward</i>	Autumn/ Winter 2019	Expansion by relocation	7,000

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

The sizes of office space are estimates.

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	31,683 buildings	21,168 contracts	21,168 contracts	1,047 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	1,523 contracts	3,753 contracts	114 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 November 2017 – January 2018

TOKYO 23 WARDS | Supply of New Office Space 2018 & Office Stock Pyramid 2018 December 7, 2017

- New supply in 2018–2020 is expected to be relatively large at around 200,000 tsubo per year, while new supply in 2021 is currently forecast at 87,000 tsubo, the smallest since 2008.
- Average new supply in 2018–2021 is expected to be 180,000 tsubo per year, exceeding 164,000 tsubo, the annual average of the past 10 years.
- Office stock at end of 2018 is expected to be 12.61 million tsubo on a rentable area basis, with small & medium-sized buildings and large buildings accounting for roughly the same amount: 5.94 million tsubo (47%) and 6.68 million tsubo (53%), respectively.

OSAKA CITY | Supply of New Office Space 2018 & Office Stock Pyramid 2018 December 7, 2017

- New supply in 2018–2021 is expected to be an average of 4,000 tsubo per year, less than one-seventh of the annual average of the past 10 years (31,000 tsubo).
- The average new supply of 4,000 tsubo per year for 2018–2021 is one-forty fifth of average new supply in Tokyo 23 Wards (180,000 tsubo per year).
- Office stock at end of 2018 is expected to be 2.78 million tsubo on a rentable area basis, with small & medium-sized buildings and large buildings accounting for roughly the same amount: 1.41 million tsubo and 1.37 million tsubo, respectively.

Metropolitan Areas Office Demand Survey Autumn 2017 December 7, 2017

- Recently, more companies are starting to allow employees to be flexible on where and when they work, in order to secure human resources and improve productivity on the back of a decline in labor force. This trend will have an impact on office space demand.
- Against this backdrop, Xymax Real Estate Institute started a survey on a semi-annual basis in autumn 2016 on office use and work styles, analyzing their influence on office space demand. This report covers the results of our third survey.

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