Xymax Real Estate Institute

Office Market Report

Tokyo | Q1 2018

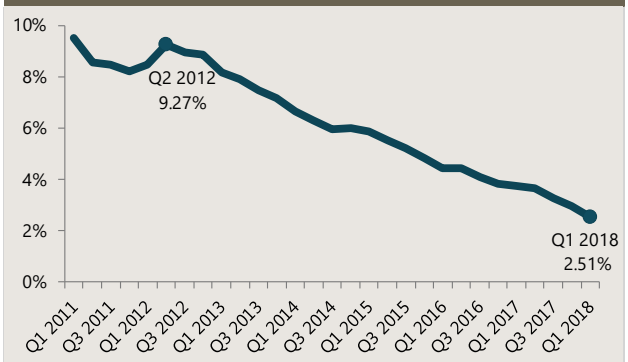
May 2, 2018

Summary

(1 tsubo = 3.3 sqm)

- In the January–March quarter, the Tokyo 23 Wards' office market saw a continued drop in the vacancy rate, as new supply of large buildings succeeded to find tenants promptly. The rising trend of new contract rent has also continued.
- The **vacancy rate** was 2.51%, down 0.45 points from the previous quarter. The **Decrease in Vacant Space** exceeded **Increase**, with 256,000 tsubo decreasing and 205,000 tsubo increasing. The **Vacancy Turnover Ratio** (the ratio of vacant space leased during the quarter to all the vacancy stock) continued to rise.
- The **New Contract Rent Index** (the level of new lease rent) was 109, up 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, remained above zero for the twelfth consecutive quarter at +15.
- The **Paying Rent Index** (the level of new lease rent and the level of existing lease rent combined) rose 1 point to 90.
- The **Average Free Rent Month of Lease with Free Rent** was 3.9 months, an increase of 0.3 months. Although the percentage of free rent of 6 months or more was small, granting of free rent has become common.

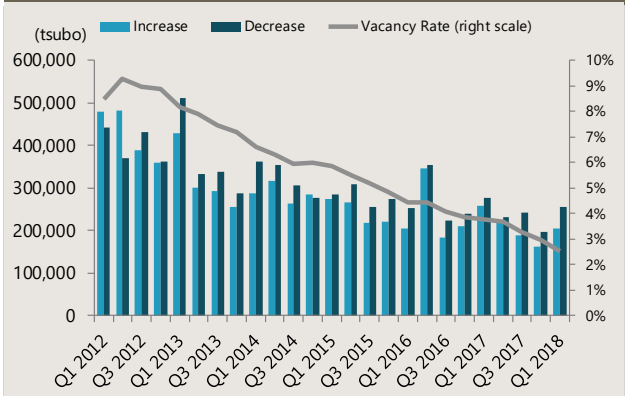
Figure 1: Vacancy Rate



	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Vacancy Rate	3.76%	3.66%	3.28%	2.96%	2.51%

Source: Xymax Real Estate Institute

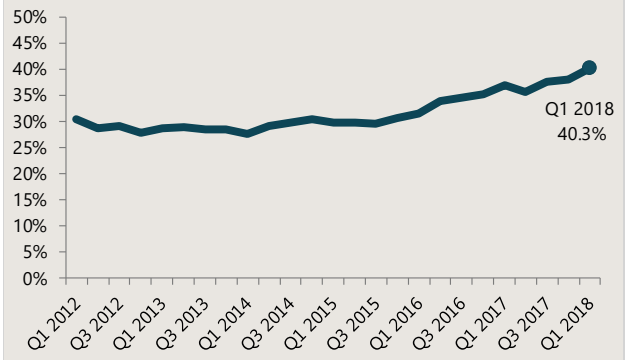
Figure 2: Increase and Decrease in Vacant Space



	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Increase	258,000	217,000	189,000	163,000	205,000
Decrease	276,000	232,000	241,000	197,000	256,000
Vacancy (right scale)	3.76%	3.66%	3.28%	2.96%	2.51%

Source: Xymax Real Estate Institute

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



	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Vacancy Turnover	36.9%	35.6%	37.5%	38.1%	40.3%

Source: Xymax Real Estate Institute

Vacancy

Figure 1 shows the **vacancy rate** in the Tokyo 23 Wards since 2011. The vacancy rate in Q1 2018 dropped by 0.45 points quarter-on-quarter to 2.51%. The rate has been declining consistently since Q3 2012.

There is demand in all areas due to the rising need for expansion and better location as companies increase their staff. New supply of large buildings is often taken almost completely before construction is completed, and secondary vacancies due to tenants' relocations to new buildings are filled by other tenants in the building.

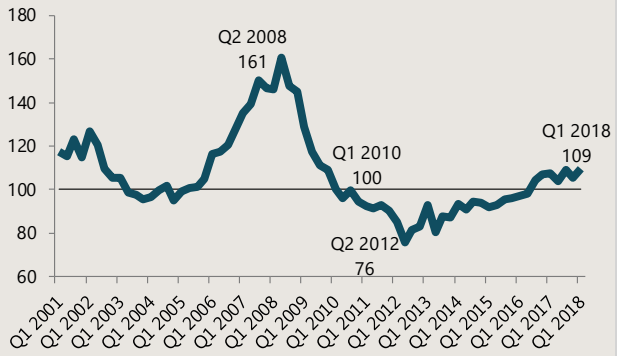
Figure 2 shows the quarterly **Increase and Decrease in Vacant Space**. The increase was 205,000 tsubo and the decrease was 256,000 tsubo. Decrease exceeded increase for 13 consecutive quarters since Q1 2015, contributing to the constant decline in the vacancy rate.

The volume of increase in Q1 2018 was larger than the previous quarter due to the completion of large properties. However, since many of the buildings were already filled by the time they were completed, the volume of decrease in vacant space was larger than the increase.

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 Q1 2018 was 40.3%, a further rise from the previous quarter. The rise continued, pushing the ratio above 40% for the first time and indicating that vacant spaces in the market continue to be steadily leased up by tenants.

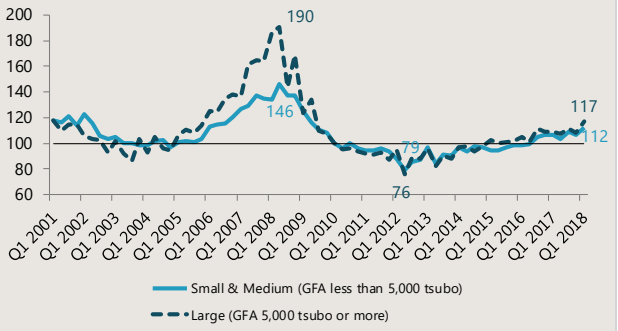
Figure 4: New Contract Rent Index



	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018
New Contract Rent Index	108	104	109	106	109

Source: Xymax Real Estate Institute

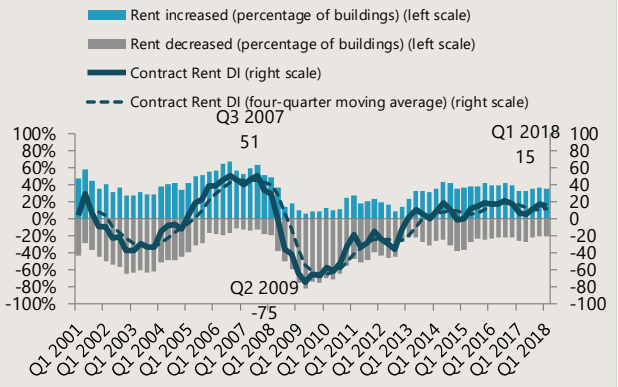
Figure 5: New Contract Rent Index by Size of Building



	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Small & Medium Buildings	107	103	109	106	112
Large Buildings	109	107	111	108	117

Source: Xymax Real Estate Institute

Figure 6: Contract Rent DI



	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Contract Rent DI	6	6	13	17	15

Source: Xymax Real Estate Institute

New Contract Rent

Figure 4 shows the **New Contract Rent Index** (Tokyo 23 Wards), the index of new lease rent levels. The index for Q1 2018 was 109, a 3-point drop from 106 in the previous quarter. Although the trend seems to be flat in recent quarters, the mild rising trend since Q2 2012 has remained unchanged.

Figure 5 is 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 112 and that for large buildings with GFA of 5,000 tsubo or more was 117, both representing a rise. New contract rent seems to be rising steadily in all building sizes.

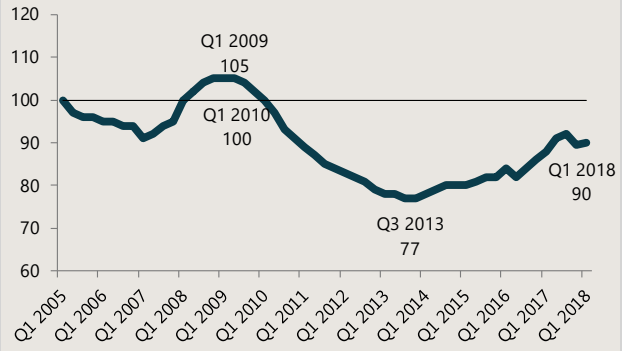
Figure 6 shows the **Contract Rent Diffusion Index (DI)**, which indicates the direction of changes in new lease rents. The DI in Q1 2018 dropped 2 points over the quarter to +15. However, the quarter marked the twelfth consecutive above-zero DI, which means the number of buildings with a rent increase exceeded those with a rent decrease.

Demand was strong in the Tokyo 23 Wards overall, with vacancies in areas that had been struggling for a while also being filled quickly. Companies with the intention to move are increasingly facing difficulties in finding a property that suits their needs. Amid such circumstances, the rise in rent has been mild.

The annual average supply between 2018 and 2021 is expected to be 180,000 tsubo, exceeding the past 10 years' average of 164,000 tsubo.* As buildings scheduled for completion in 2018 are being leased up steadily, attention should be paid to the demand for secondary vacancies that will become available.

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

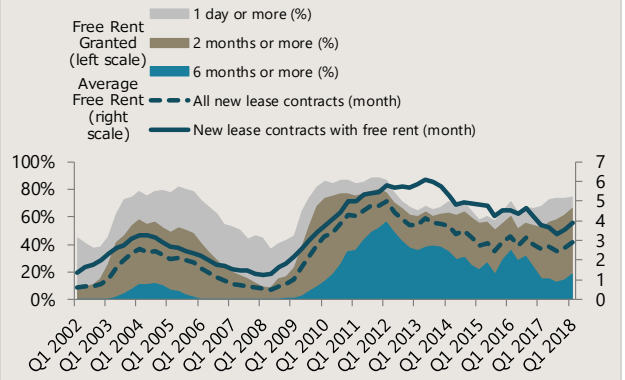
Figure 7: Paying Rent Index



	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Paying Rent Index	88	91	92	89	90

Source: Xymax Real Estate Institute

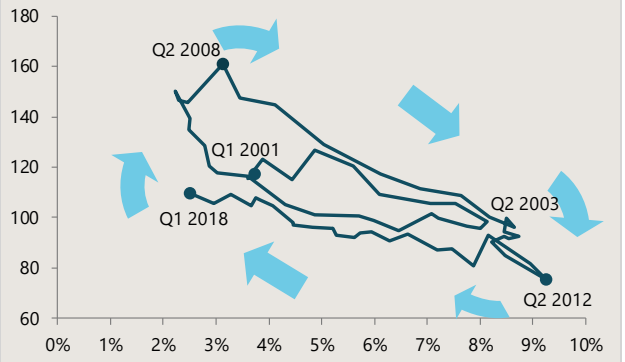
Figure 8: Free Rent



		Q1 2017	Q2 2017	Q3 2017	Q4 2017	2018Q1
Ratio of Free Rent Granted	1 day +	67.8%	72.3%	73.1%	73.7%	73.9%
	2 mon. +	52.1%	56.3%	58.0%	61.4%	65.8%
	6 mon. +	14.9%	15.1%	12.6%	14.0%	18.0%
Average Free Rent Month	All	2.6	2.7	2.4	2.6	2.9
	w/ FR	3.8	3.7	3.3	3.6	3.9

Source: Xymax Real Estate Institute

Figure 9: Market Cycle



	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Vacancy Rate	3.76%	3.66%	3.28%	2.96%	2.51%
New Contract Rent Index	108	104	109	106	109

Source: Xymax Real Estate Institute
(Vacancy rates before March 2011 are based on data by a major leasing agent)

Paying Rent

Figure 7 shows changes in the **Paying Rent Index**, which covers both new lease rents and existing lease rents. The index in Q1 2018 was 90, a rise of 1 point. It has remained on a mild rising trend since Q3 2013.

Free Rent

Figure 8 shows the trend of the ratio of new lease contracts with free rent to all new lease contracts (**Ratio of Free Rent Granted**) and the average free rent period (**Average Free Rent Month**). The Average Free Rent Month of all new lease contracts was 2.9 months in Q1 2018, up 0.3 months from the previous quarter, while that of contracts with free rents was 3.9 months, also up 0.3 months.

Although the free rent ratio and number of months rose in Q1 2018 partly due to moves to secure unit rent by granting free rent for a long period, the number of free rent months is on a declining trend in the overall market. However, while the ratio of free rent of 6 months or more is low, granting a certain amount of free rent has become common practice, such as during construction work after moving in.

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 cyclicality 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 2018. During Q1 2018, the chart moved to the upper left due to a drop in vacancy rates and a rise in rent.

Reference

Figure 10: Major Building Completions (Q1 2018)

Name	Floors Above Ground / Below Ground	Ward	Address	Completion	Leasable space (tsubo)
Sumitomo Fudosan Osaki Garden Tower	24 / 2	Shinagawa	1-1-1 Nishishinagawa	2018/01	36,943
Taiyo Seimei Nihonbashi Bldg.	27 / 5	Chuo	2-11-1 Nihonbashi	2018/01	6,673
G-BASE Tamachi	18 / 0	Minato	5-29-11 Shiba	2018/01	3,771
Tokyo Midtown Hibiya	35 / 4	Chiyoda	1-1-2 Yurakucho	2018/02	37,087

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

Figure 11: Major Office Relocations (Q1 2018)

Company	From	To	Month Year	Purpose	Size (tsubo)
Sega Sammy Group	Canal Side Building *Shinagawa Ward*	Sumitomo Fudosan Osaki Garden Tower *Shinagawa Ward*	Autumn 2018	Consolidation by relocation	13,280
Mitsubishi Shokuhin	Tokyo Ryutsu Center *Ota Ward*	(Tentative) Kasuga/Korakuen Ekimae Redevelopment South Block SA Tower *Bunkyo Ward*	May 2020	Better efficiency	5,400
Japan Securities Dealers Association	Tokyo Shoken Kaikan *Cnuo Ward*	Taiyo Seimei Nihonbashi Building *Cnuo Ward*	Autumn 2018	Better facility	1,480
Ohba	Company building *Meguro Ward*	Kowa Hitotsubashi Building *Chiyoda Ward*	Dec 2018	Better location and efficiency	974
Nippon Thompson	Takanawa Center Building *Minato Ward*	Sumitomo Shibakoen Building *Minato Ward*	Feb 2018	Redevelopment of former location	900
OGIS-RI	Shinagawa Intercity Tower A *Minato Ward*	Sumitomo Fudosan Osaki Garden Tower *Shinagawa Ward*	May 2018	Unknown	800

Source: Complied 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			
Market	Tokyo 23 Wards			
Building Size	All	All	All	All / Large / Small & Medium
Release	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	32,044 buildings	19,408 contracts	19,408 contracts	683 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.	• Increase in volume of vacant space a. Space in existing buildings formerly occupied by tenants b. Total rentable area of new completions • Decrease in volume of vacant space 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 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.	• 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"	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). This model shows changes in new contract rents after removing property-specific variables.

Overview of Researches

	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		
Market	Tokyo 23 Wards		
Building Size	All	All	All
Release	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	1,075 contracts	3,730 contracts	111 contracts
How to Calculate	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).	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). 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 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. 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.

Appendix

Xymax REI Research Updates February 2018 – April 2018

Average Offer Periods of Offices February 1, 2018

- The average offer period for blocks used as office in the Tokyo 23 Wards is five months.
- (By location) Five central wards: five months; 18 peripheral wards: six months
- (By size (gross floor area)) Less than 5,000 tsubo: five months; 5,000 tsubo or more: four months
- (By building age) Less than 20 years: four months; 20 years or older: five months
- (By size of office block) Less than 100 tsubo: five months; 100 tsubo or more: five months

Corporate Activity and Workstyle Reforms as Seen in Office Relocation March 13, 2018

- Xymax Real Estate Institute conducted a questionnaire survey of companies that moved into a new office between 2016 and 2017 and summarized the relationship between office demand and workstyles and the changes in such relationship as seen in companies' office relocation behavior.
- In terms of the type of office relocation, "relocation for expansion" was the most popular (46.6%), followed by "new opening" (26.2%) and "relocation for downsizing" (13.6%), indicating robust demand for offices.
- The most popular reason for the relocation was "space became small due to personnel increase" (41.7%). 28.6% of companies chose "to heighten motivation of employees," indicating companies' high interest in employee satisfaction.
- In choosing an office, companies placed the most importance in "rent," "size of space" and "proximity to nearest station." On the other hand, the top requirement that was forsaken was also "rent." This indicates that a certain number of companies increased their budget after struggling to find an office that met their requirements.
- In terms of difficulties companies faced between considering relocation and completion of the move, the top replies included "narrowing down the properties," "confirming the layout plan" and "negotiating contract terms (e.g. rent)."
- 60.7% of companies introduced a new office layout when moving into a new office in order to improve workstyles. Specific examples include "an open meeting space," "space for employees to refresh" and "ABW"*.
- The most popular purpose of introducing a new office layout was to "improve comfort of the office space" (34.5%), indicating companies' awareness toward employee satisfaction.

*ABW (Activity Based Working): A layout with a variety of work areas that can be chosen according to the work, such as booths for concentrating on solo work and space to collaborate in a team.

Contact

Xymax Real Estate Institute
Phone: +81 3 3596 1477
Fax: +81 3 3596 1478
Email: info-rei@xymax.co.jp