

Office Market Report

Tokyo | Q2 2018

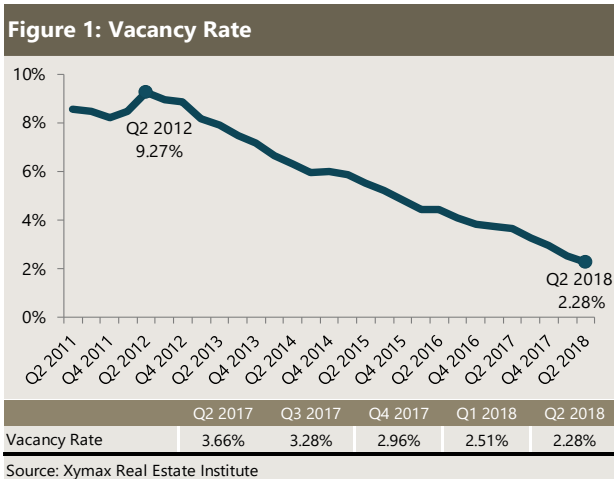
August 1, 2018



Summary

(1 tsubo = 3.3 sqm)

- In the April–June quarter, the Tokyo 23 Wards' office market saw a continued drop in the vacancy rate, as companies' demand for office expansion remained robust, new properties were already filled by the time they were completed, and existing vacancies succeeded to find tenants promptly. The rising trend of new contract rent also remained unchanged.
- The **vacancy rate** was 2.28%, down 0.23 points from the previous quarter. The **Decrease in Vacant Space** exceeded **Increase**, with 212,000 tsubo decreasing and 184,000 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 113, up 4 points. The **Contract Rent Diffusion Index**, calculated by subtracting the percentage of buildings with a rent decrease from that of buildings with a rent increase, remained above zero for the thirteenth consecutive quarter at +22.
- The **Paying Rent Index** (the level of new lease rent and the level of existing lease rent combined) rose 1 point to 91.
- The **Average Free Rent Months of Lease with Free Rent** was 3.1 months, a decrease of 0.1 months. Granting of free rent as an incentive remained low, with the ratio of free rent granted for six months or more at 6.7%.



Vacancy

Figure 1 shows the **vacancy rate** in Tokyo 23 Wards since 2011. The vacancy rate in Q2 2018 dropped 0.23 points quarter-on-quarter to 2.28%. The rate has been declining consistently since Q3 2012.

Amid the continuous rise of the jobs-to-applicants ratio, companies are hiring aggressively to secure personnel, resulting in strong demand for office space expansion. Vacancies are often filled from within the building before they go on the market, and buildings completed during this quarter have been taken almost completely. We believe that buildings scheduled to be completed are also being leased up steadily.

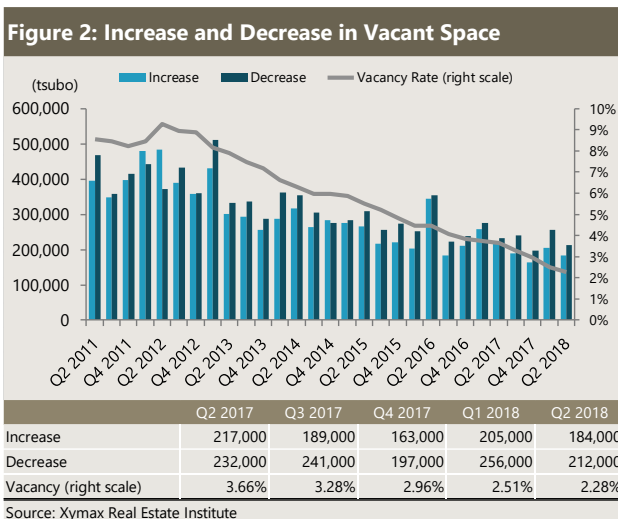


Figure 2 shows the quarterly **Increase and Decrease in Vacant Space**. The increase was 184,000 tsubo and the decrease was 212,000 tsubo. Decrease exceeded increase for 14 consecutive quarters since Q1 2015, contributing to the constant decline in the vacancy rate.

The amount of new supply was quite large due to the completion of large properties in Q2 2018. However, due to limited vacancies in existing properties and robust demand, the decrease in vacant space remained larger than the increase.

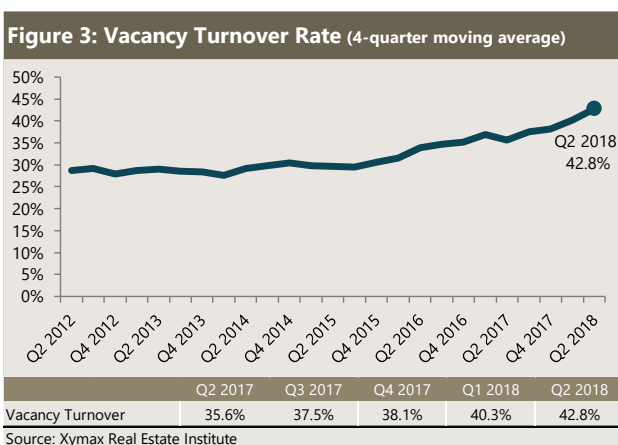
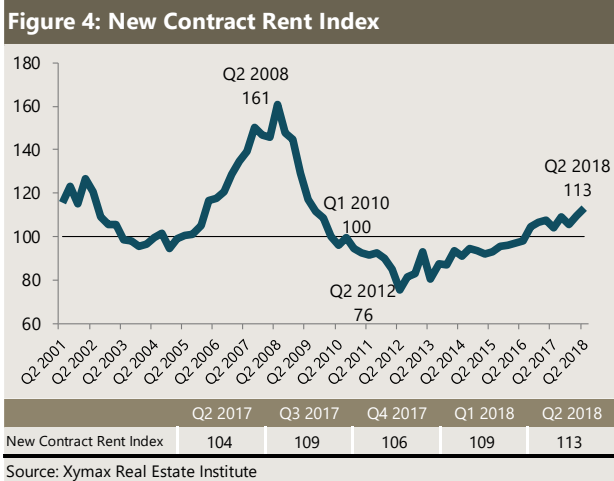


Figure 3 shows the **Vacancy Turnover Ratio** (four-quarter moving average), which is the ratio of vacant spaces leased to tenants during the quarter to all the vacant office stock (vacancy at the start of the quarter + vacancy added during the quarter).

The ratio in Q2 2018 was 42.8%, a further rise from the previous quarter. Vacant spaces in the market are being leased up by tenants at an accelerating pace as existing vacancies are filled and newly completed office buildings find tenants promptly.



New Contract Rent

Figure 4 shows the **New Contract Rent Index**, the index of new lease rent levels. The index for Q2 2018 was 113, a 4-point rise from 109 in the previous quarter. A lessors' market has continued due to tight supply and demand, with building owners making aggressive moves to raise rent as they look for tenants for the remaining few vacancies.

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 115, up 3 points from the previous quarter. Despite the index for large buildings with a GFA of 5,000 tsubo or more dropping 1 point to 116, there is no change to the continued rising trend since 2012.

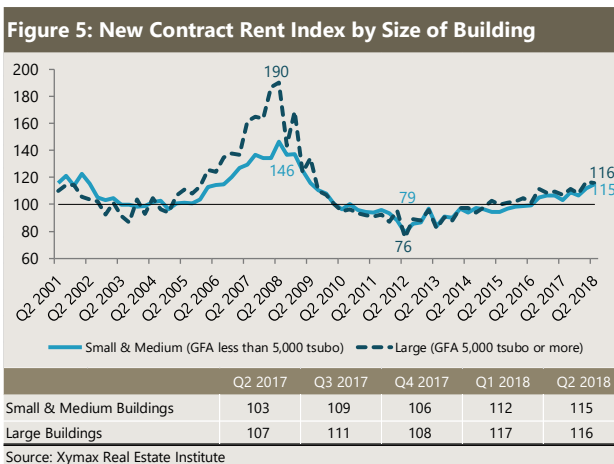
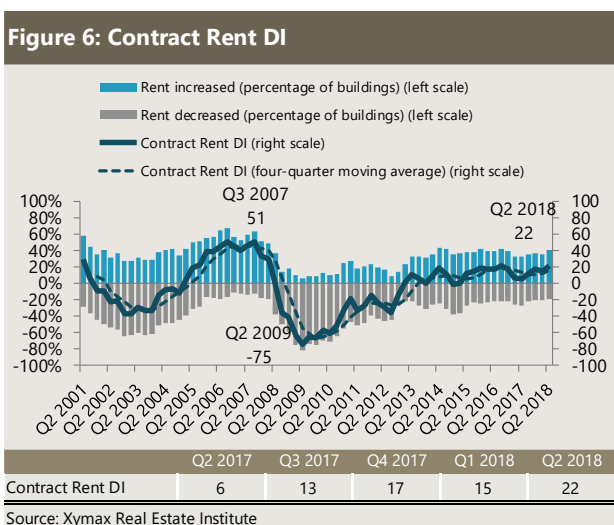
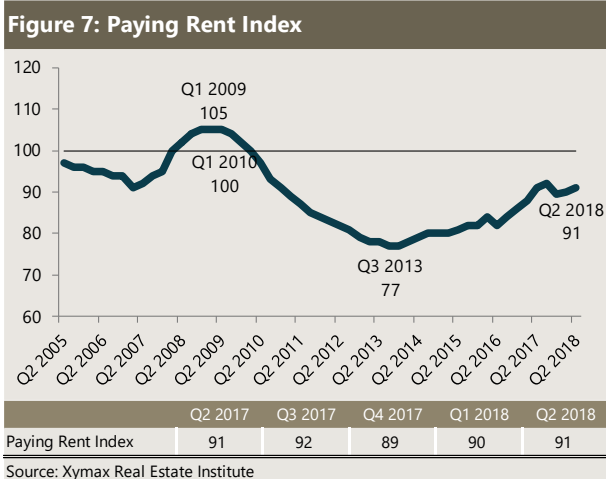


Figure 6 shows the **Contract Rent Diffusion Index (DI)**, which indicates the direction of changes in new lease rents. The DI in Q2 2018 rose 7 points over the quarter to +22. The quarter marked the thirteenth consecutive above-zero DI, which means the number of buildings with a rent increase exceeded those with a rent decrease.



Due to companies' needs to expand, the office space market is extremely tight, with properties located in non-central areas or far from stations also taken promptly. Amid such circumstances, not only are new rents set higher but rent conditions are sometimes maintained based on a fixed term lease contract, with priority on securing long-term tenants.

Changes in future supply and demand require attention, as a relatively large amount of office supply is scheduled from this year through 2020.



Paying Rent

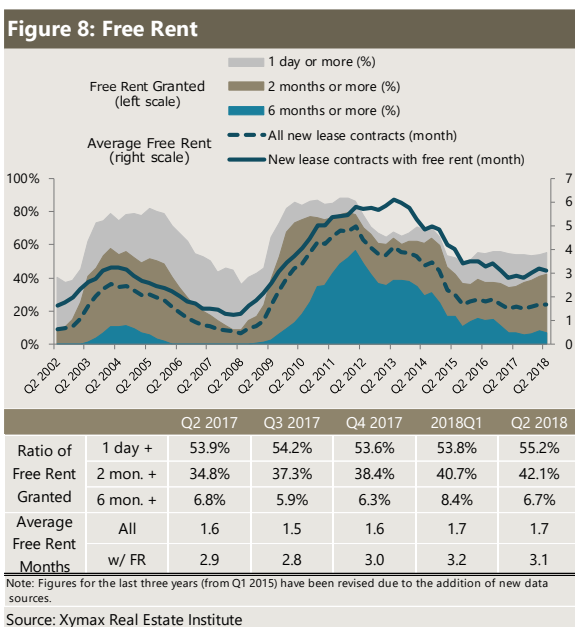
Figure 7 shows changes in the **Paying Rent Index**, which covers both new lease rents and existing lease rents. The index in Q2 2018 was 91, a rise of 1 point. Not only new rents but also rents to existing tenants were raised in many cases.

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**). In Q2 2018, the average free rent period of contracts with free rents was 3.1 months, down 0.1 months from the previous quarter. The figure has remained roughly constant at around 3 months for the past year.

The ratio of free rent granted long-term (six months or more) remained low at under 10%. On the other hand, free rent has been granted to more than half of the lease contracts, indicating that free rent has become common practice.

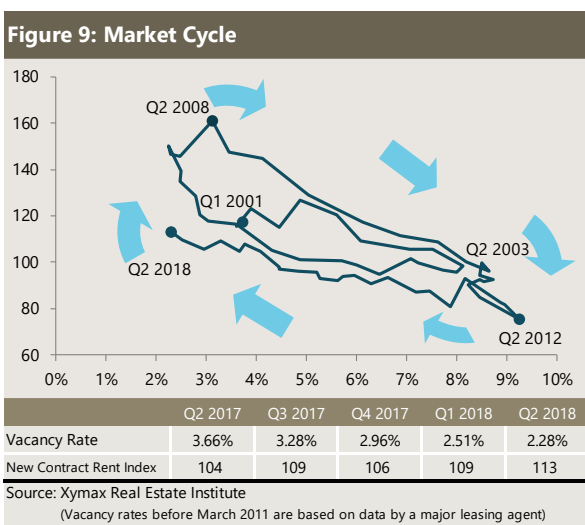
Note: Figures for the last three years (from Q1 2015) have been revised due to the addition of new data sources.



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 2018. During Q2 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 (Q2 2018)

Name	Floors	Ward	Address	Completion	Leasable space (tsubo)
	Above Ground / Below Ground				
PMO Hatchobori Shinkawa	9 / 0	Chuo	2-9-11 Shinkawa	2018/04	920
msb Tamachi Tamachi Station Tower S	31 / 2	Minato	3-1-21 Shibaura	2018/05	23,406
Sumitomo Fudosan Onarimon Tower	22 / 2	Minato	1-1-1 Shibakoen	2018/05	5,594
Sumitomo Fudosan Kojimachi First Bldg.	10 / 1	Chiyoda	4-2-6 Kojimachi	2018/05	2,894
Nihonbashi Takashimaya Mitsui Bldg.	32 / 5	Chuo	2-5-1 Nihonbashi	2018/06	16,318

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

Figure 11: Major Office Relocations (Q2 2018)

Company	From	To	Month Year	Purpose	Size (tsubo)
VOYAGE GROUP	Shibuya First Place, etc. <i>Shibuya Ward</i>	Nanpeidai Project (tentative name) <i>Shibuya Ward</i>	May 2019	Consolidation, better efficiency	1,584
CyberAgent	Shibuya Mark City, etc. <i>Shibuya Ward</i>	Ameba Towers, Shibuya Scramble Square <i>Shibuya Ward</i>	Mar 2019	Consolidation	More than 10,000
Itochu Enex	Toranomon Twin Building <i>Minato Ward</i>	Kasumigaseki Building <i>Chiyoda Ward</i>	Feb 2019	Expansion, better efficiency	2,391
Net Protections	Ginza First Building, etc. <i>Chuo Ward</i>	Sumitomo Fudosan Kojimachi First Bldg. <i>Chiyoda Ward</i>	Jul 2018	Expansion, consolidation	960
Money Forward	Morinaga Plaza Main Building, etc. <i>Minato Ward</i>	msb Tamachi Tamachi Station Tower S <i>Minato Ward</i>	Jul 2018	Expansion, consolidation	936
Solxyz	Tokuei Building <i>Minato Ward</i>	msb Tamachi Tamachi Station Tower S <i>Minato Ward</i>	H1 2019	Redevelopment of former location	Approx. 300

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

The sizes of office space are estimates.

Survey Overview				
	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	32,370 buildings	17,949 contracts	17,949 contracts	967 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>

Survey Overview			
	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 independently collected by Xymax.
Data Used in Recent Quarter	1,442 contracts	3,694 contracts	252 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 May 2018 – July 2018

Energy Consumption and Energy Cost in Office Buildings June 6, 2018

- Energy consumption: Continued on a mild declining trend, with the average for 2017 at 130.2 MJ/m²/month.
- Energy price per unit: After being on a declining trend since 2015, turned upward in 2017, with the annual average at 1.98 yen/MJ.
- Energy cost: The smallest figure since the start of measurement, with the average for 2017 at 252.2 yen/m²/month.

Greater Tokyo Office Worker Survey 2018 June 6, 2018

- 8.1% of respondents teleworked for any length of time over a week. However, we found that there was a disparity between respondents' awareness that they were teleworking and the actual teleworking ratio (18.3%).
- Satisfaction in the current workplace environment of those who teleworked (59.4%) was nearly double that of those who did not telework (31.2%).
- 44.6% of respondents had positive intentions toward teleworking in the future. Intentions were especially high (more than 50%) among men aged 20–24 and 40–44 and women aged 25–29 and 30–34. In terms of child status, the intention was the highest among those with child(ren) in the lower grades of elementary school or younger (54.1%).

Metropolitan Areas Office Demand Survey Spring 2018 July 3, 2018

- 40.0% of companies saw an increase in the number of office users over the past year, exceeding companies that saw a decrease (13.3%). 9.1% of companies expanded their office space, while 2.7% downsized, indicating that office demand was robust.
- More companies are making efforts to offer alternative workplaces, such as work-from-home programs (20.6%) and satellite and serviced offices.
- Companies that replied that the number of office users will increase (41.1%) exceeded those that expected a decrease (5.2%). Similarly, companies that replied that they wanted to expand their office space (23.5%) exceeded those that wanted to downsize (4.6%), indicating that office demand will remain robust.

Office Offer Period and Asking Rent July 20, 2018

- A survey on changes in rent during offer periods revealed that 82.6% of office blocks did not change the rent, 12.8% lowered the rent from the initial asking rent, and 4.6% raised the rent.
- More than 90% of office blocks with offer periods equivalent to the average office offer period (five months) or shorter found tenants without changing their asking rent.
- The longer the offer period becomes, the smaller the percentage of office blocks that did not change their initial asking rent before finding a tenant will be.

Contact

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