

Analysis of Length of Occupancy of Office Tenants in Tokyo 23 Wards (2018)

Estimation of average occupancy period of tenants and analysis of departing tenants

December 7, 2018

In 2014, Xymax Real Estate Institute (hereinafter referred to as "Xymax REI") analyzed and published a report on the occupancy period of office tenants in the Tokyo 23 Wards.*¹ Using a statistical method, the analysis estimated the average occupancy period of office tenants, which is the period of time until fifty percent of the tenants, including ongoing tenants at the time of data collection, moves out of the building. Four years after the previous survey, we conducted a new estimation using the same method.

The actual period of time from a tenant's start of occupancy to departure varies, and not all tenants stay in a building for the average occupancy period. Therefore, in this report we also focused on tenants that had moved out and analyzed the actual occupancy periods of departed tenants to examine the factors that affect the lengths of occupancy.

In addition, since there is a certain number of tenants who move out within less than two years, which is shorter than the two-year contract period of a general office lease in Japan, we conducted interviews to gather the reason and background of the departure of each such tenant.

*¹ Refer to "How long will the office tenant continue to stay?", published on May 26, 2014

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Key Findings

1. Average occupancy period of office tenants

- The estimated **average occupancy period of office tenants**, including ongoing tenants, was 9.6 years.
- The estimated percentage of tenants continuing to stay in a building for over two years was 93.8%.
- The results were not significantly different from when the analysis in 2014 was carried out.

2. Analysis of departed tenants

- The occupancy period of departed tenants was 5.7 years on average and 4.4 years median.
- There was no correlation between the contract terms (i.e. occupied area, unit rent) or building specifications (i.e. gross floor area, age) and the occupancy period.
- Occupancy periods tend to be shorter when rents are declining on the back of a downturn in the office market, and longer when rents are rising.

3. Cases of tenants departing within less than two years (from the interviews)

- Although lease of office space is generally a two-year contract in Japan (automatically renewed), there is a certain number of tenants who departed within less than two years. The reasons and backgrounds to their departure vary.

[About the data]

This report uses tenant management data gathered independently by Xymax REI. The subjects of the analysis are lease contracts for office use of office buildings located in the Tokyo 23 Wards. The data collection period was approximately ten years from January 2008 to March 2018.

In this report, “occupancy period” represents the period from the start date to the end date of a lease contract. Contracts confirmed during the data collection period were subject to the analysis. **Figure 1** illustrates the concept of the occupancy period of the contracts subject to the analysis.

Pattern ① of the figure illustrates contracts of tenants that had already moved into the building at the start of data collection and moved out during the period of data collection. The occupancy periods are determined.

Pattern ② represents contracts of tenants that moved in and out during the data collection period. The occupancy periods are determined.

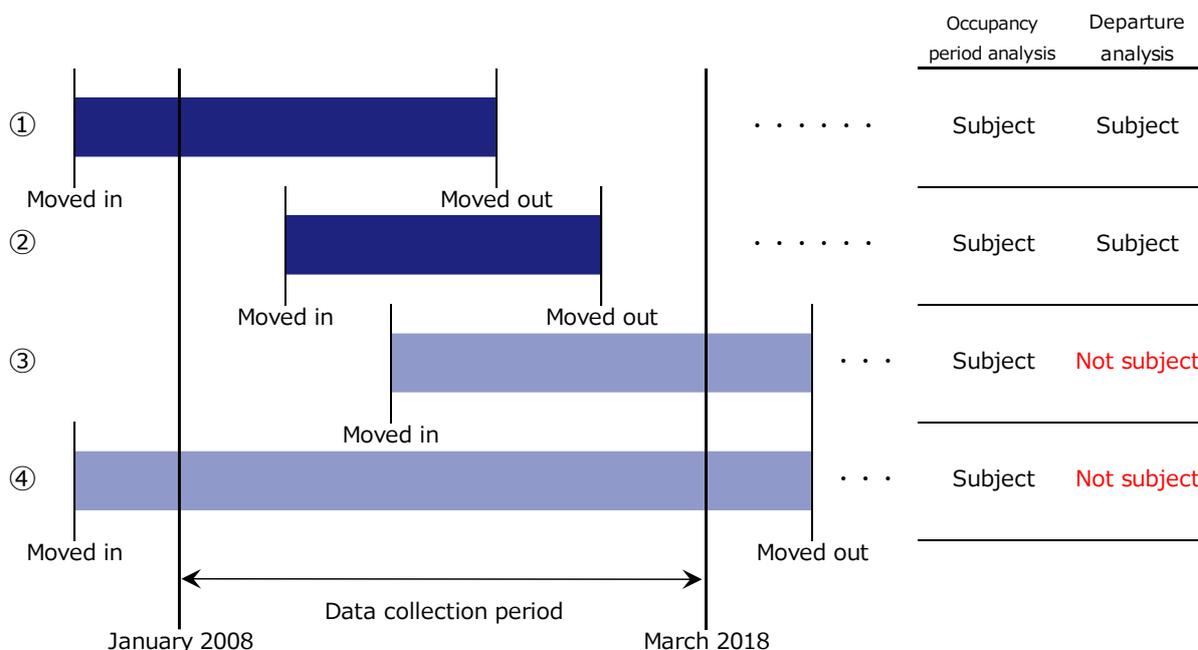
Pattern ③ are contracts of tenants still staying in the building at the time of the end of the data collection period. The occupancy periods could not be determined at the time of the survey.

Pattern ④ illustrates contracts of tenants that had already moved into the building at the start of data collection and were still staying in the building at the end of data collection. The occupancy periods could not be determined at the time of the survey.

Patterns ③ and ④ were included in the subjects of the occupancy period analysis as censored data but were not subject to the analysis of departed tenants.

“1. Average Occupancy Period of Office Tenants” below was carried out using the data of 2,947 contracts of ①, ②, ③ and ④ above, while “2. Analysis of Departed Tenants” was conducted using the data of 1,273 contracts of ① and ②, whose tenants had already departed.

Figure 1: Contracts Subject to the Analysis



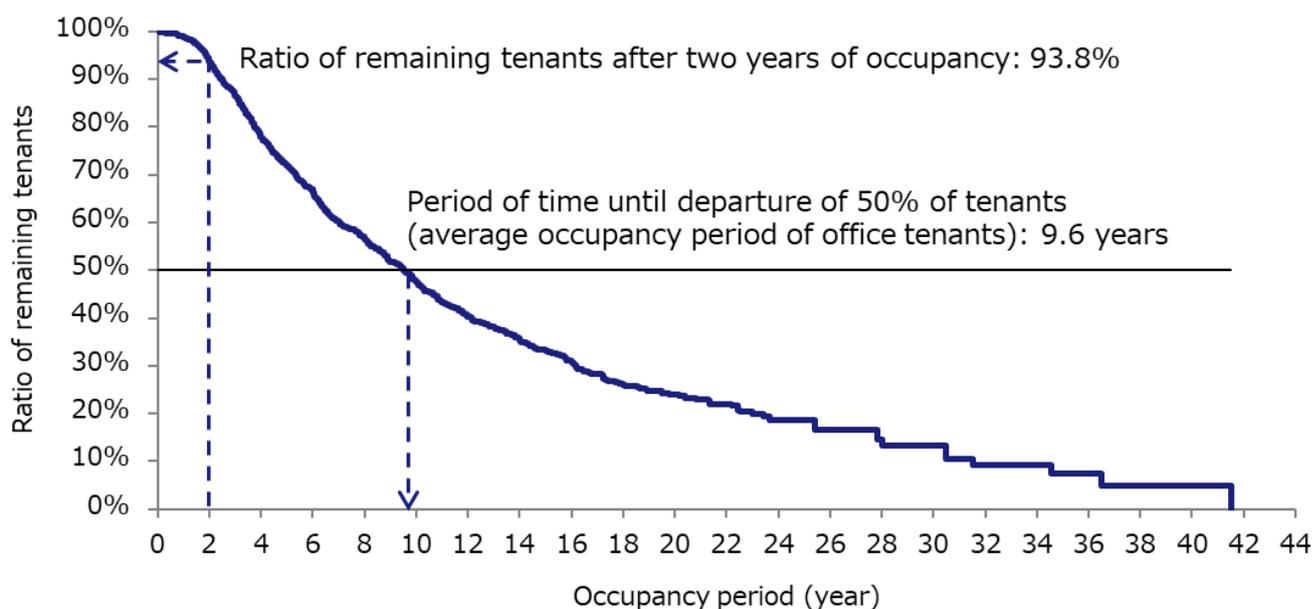
1. Average Occupancy Period of Office Tenants

Figure 2 indicates the ratio of remaining tenants by the length of occupancy derived from the Kaplan-Meier method.*2 The ratio of remaining tenants at the initial point is 100% (occupancy period = 0 month). The ratio decreases as the occupancy period becomes longer.

Our analysis found that the period from the start of the occupancy to the time until fifty percent of the tenants depart from the building (**average occupancy period of office tenants**) was 9.6 years. In Japan, lease of office buildings is generally a two-year contract. Our estimate shows that 93.8% of tenants continue to stay over two years; in other words, only 6.2% of tenants leave within two years.

The results of this analysis did not show a significant difference in the average occupancy period of office tenants from that published in 2014 (10 years), and the percentage of tenants continuing to stay for over two years was the same.*1

Figure 2: Tenants’ Length of Occupancy and the Ratio of Remaining Tenants



*1 Refer to “How long will the office tenant continue to stay?”, published on May 26, 2014

https://www.xymax.co.jp/english/news_research/?type=research

*2 Kaplan-Meier Method

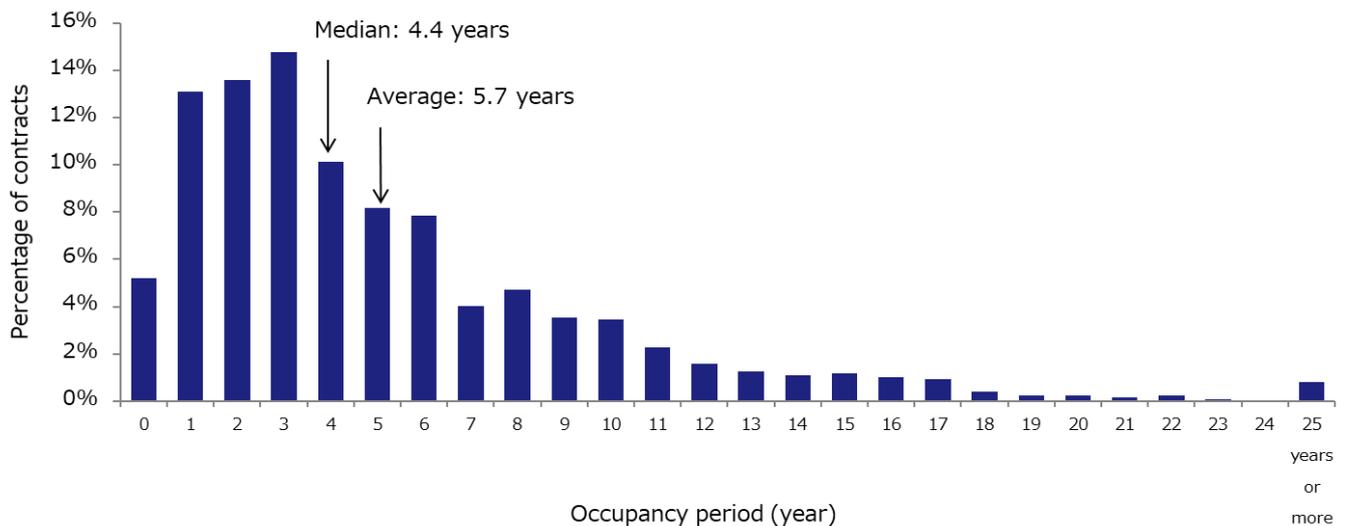
A method of survival analysis. It does not assume a specific probability distribution in the estimation of the survival rate and does not include an explanatory variable. In our analysis, the departure of tenants is considered an “event,” tenants that occupy the space at the end of the survey period, “censored data”, and the ratio of remaining tenants, a “survival rate”.

2. Analysis of Departed Tenants

2.1 The reality of departed tenants

“1. Average Occupancy Period of Office Tenants” is an estimated average occupancy period using data of ongoing tenants, but the actual period of time from the start of occupancy to departure varies between tenants. Therefore, we looked into the occupancy period of departed tenants only, which was 5.7 years on average and 4.4 years median^{*3} (Figure 3).

Figure 3: Length of Occupancy of Departed Tenants



*3 A median is the value centrally positioned when data is aligned in ascending order. It is less likely to be affected by outliers compared to average values, and is used as the representative value of an asymmetrical distribution such as that of annual income. (In a symmetrical distribution, the average value will be equal to the median value.)

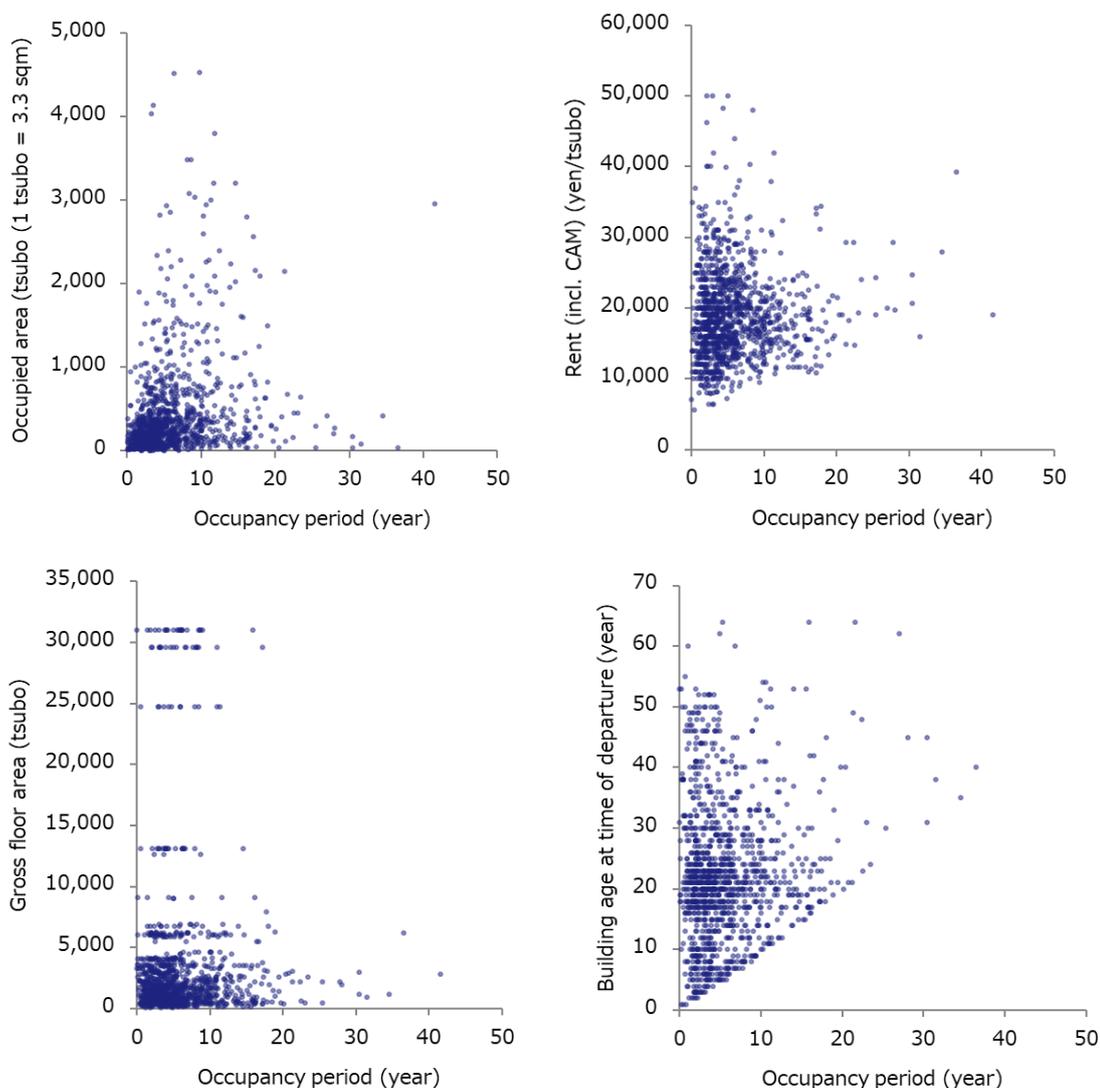
2.2 Relationship between occupancy period and various elements

We then examined whether there was a correlation between the length of occupancy of departed tenants and the rent level or occupied area. We found no clear correlation between the occupied area, unit rent inclusive of CAM, gross floor area of the building or the building’s age at the time of departure, and the length of occupancy (**Figure 4**).

When deciding which building to rent, tenants would usually have understood the size or age of the building before agreeing on contract terms such as the occupied area and unit rent and entering into a lease contract with the building owner. Therefore, it would be unlikely for a tenant to move out of a building due to the size or age of the building. We also think it is unlikely for a tenant to leave the building due to the occupied area or unit rent unless the financial situation or management policy of the tenant has changed dramatically or the rent has been increased significantly.

Therefore, we believe that the length of occupancy until departure has almost no correlation with the terms of the lease contract or the building’s specifications such as size.

Figure 4: Relationship Between Unit Rent, Building Size, etc.



2.3 Relationship with the office market

We examined chronological changes in departed tenants’ occupancy to see the relationship with the office market.

Figure 5 is the vacancy rate and an index of newly-signed unit rent in the 23 Wards. This shows that the vacancy rate rose between 2008 and 2012 while rent declined. Meanwhile, between 2013 and 2018, the vacancy rate dropped while the rent was on a rising trend.

Figure 6 shows changes in departed tenants’ occupancy over the same period as in **Figure 5**. Occupancy was shorter during the drop in rent between 2008 and 2012 than during rising rent between 2013 and 2018. Vacancies usually increase when rents drop, providing tenants (lessees) with more choices for relocation at a lower rent than the rent of the building they currently occupy. During such periods, tenants can enjoy benefits such as a less rent burden even if considering relocation costs and the ability to move into a better located or better spec building even if the rent was the same. On the other hand, building owners (lessors) act to aggressively capture tenants by reducing tenants’ relocation costs such as by setting longer free rent periods, in an effort to increase rent income as much as possible. This results in a relatively frequent relocation of tenants, who increasingly move out of buildings after a short occupancy. The rising cost awareness due to factors such as bankruptcy of companies and consolidation of offices as well as headcount reductions during recessions when rents decline is also believed to have an effect on shorter occupancy periods.

On the other hand, vacancies in the market become scarce when rents are rising, with vacancies sometimes taken by the need for expansion within the building before going on the market. Tenants may be unable to find a preferable building to relocate to and forced to postpone relocating. During these periods when the lessor side has the advantage, building owners tend to avoid tenants who only intend to stay for a short period of time. They prioritize tenants who will stay for a long period of time since general building owners try to avoid vacancy periods and complicated paperwork caused by changes in tenants and wish to establish a good relationship with the lessees. We believe these are the reasons why occupancy periods are relatively longer during rising rent than during declining rent.

Figure 5: Vacancy Rate and Newly-signed Rent Index

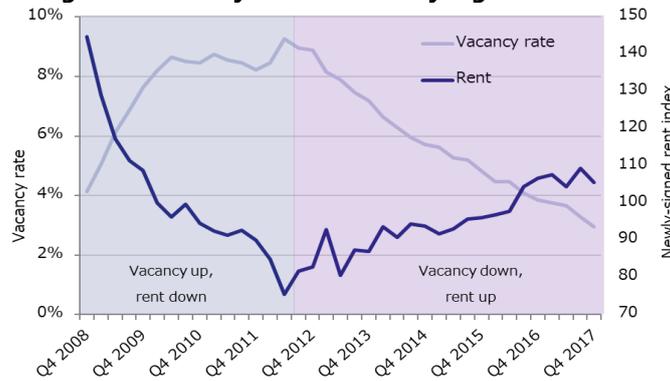
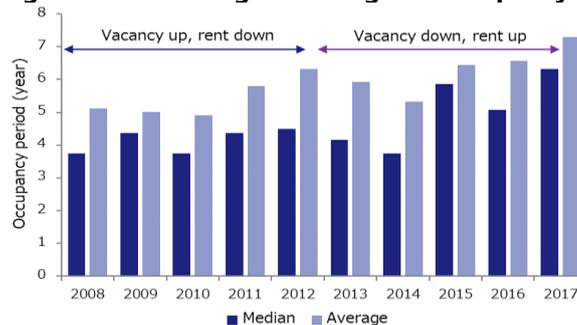


Figure 6: Chronological Change in Occupancy Period



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3. Cases of Tenants who Moved Out Within Less than Two Years (From the Interviews)

In Japan, a typical lease of office buildings is a two-year contract (automatically renewed). Despite this situation, there constantly is a certain number of occupancy periods of less than two years. Therefore, we carried out individual interviews about the reason of the departure of tenants who moved out within less than two years.*4

The cases included departures (relocations) due to circumstances unexpected by the tenant as well as a large number of departures by tenants who had originally intended to stay only for a short period of time. The following are some examples of the reasons for departure.

*4 The interviews were conducted with the persons who were in charge of building operation performing departure procedures of the departing tenants.

[Examples of departures due to unexpected circumstances]

- The tenant cancelled the contract and relocated to a larger block that became available within the same building. (Relocation within the same building)
- The tenant relocated to a larger block they were looking for in a different building. (Relocation to a different building)
- Due to rapid expansion of business, the tenant relocated to a higher-grade building, to which other departments that occupied a different building were consolidated.
- The tenant downsized its business and relocated to the head office building due to a rapid downturn of business.
- The tenant moved out due to bankruptcy.

[Examples of short periods of occupancy intended from the beginning of the occupancy]

- The tenant occupied the building while its own building/parent company's building was being rebuilt.
- The tenant occupied the building only during the development period of a contract system development project.
- A construction company occupied the space as a workers' station for a construction site nearby.
- A condominium developer temporarily used the space as a model room for marketing.
- The tenant's occupancy was until the end of March, since the work was a government-contract project and the budget was prepared on a fiscal year basis.
- The contract was a short fixed-term leasehold at the request of the owner who was concerned about the creditworthiness of the tenant, which was a startup company. (The tenant moved out after expiry of the leasehold.)
- An ongoing tenant temporarily used vacant space within the building to store goods while the tenant's space was undergoing a layout change.

[Summary]

The average occupancy period of office tenants, including those that have continued to stay in the building, is estimated at 9.6 years. This was not significantly different from when the previous analysis was carried out in 2014. However, since actual occupancy periods vary between tenants, this time we conducted an analysis of departed tenants only, the result of which was an average occupancy period of 5.7 years (the median was 4.4 years). The analysis revealed that the length of occupancy was not influenced by the terms of the lease contract and building specifications but by the office market environment.

Furthermore, since there constantly is a certain number of tenants with less than two years occupancy, we looked into the individual circumstances of their departures. The reasons and backgrounds to the departures varied, with tenants not only relocating (i.e. departing) due to the market situation but also having intended a short occupancy from the beginning in some cases.

Many building owners consider stable income as the attraction of the real estate lease business and want tenants to stay in their buildings for a long period of time instead of having vacancies for a long time.^{*5} Therefore, in the current office market environment of extremely low vacancy rates, there tend to be few buildings that will accept tenants with short occupancy needs. On the other hand, the companies, who are the tenants, now require flexibility in the time and place for work on the back of workstyle reforms, which has given rise to rental needs that cannot be met with conventional two-year (automatically renewed) lease contracts.

Going forward, it is likely that new office services that cater to a wide variety of tenants will emerge and the forms of building leases will diversify so as to fill such discrepancies between building owners and tenants.

*5 Refer to "Building Owner Survey 2018," published on October 25, 2018

https://www.xymax.co.jp/english/news_research/?type=research

Survey Overview	
Target	Office lease contracts of office buildings located in the Tokyo 23 Wards
Aggregation period	January 2008 – March 2018
Data source	Tenant management and property data gathered independently by Xymax REI
No. of data	2,947 contracts, of which 1,273 are contracts of departed tenants

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