

Office Market Report

Tokyo | Q2 2019

August 7, 2019



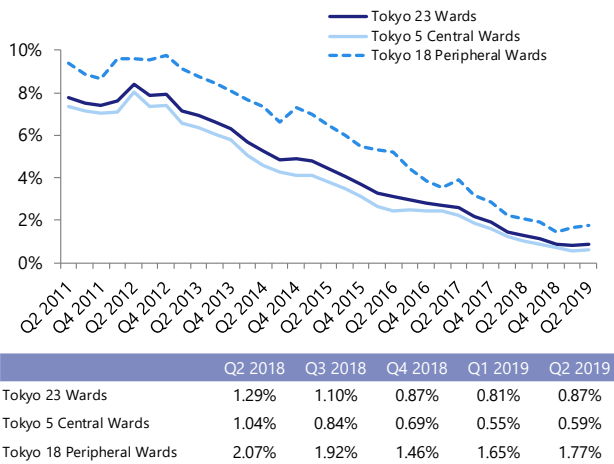
Summary

(1 tsubo = 3.3 sqm)

- In the April–June 2019 quarter, the Tokyo 23 Wards' office market saw a rise in vacancy rate for the first time in 18 quarters as some formerly occupied spaces were not filled from within the building and went on the market, although office space needs remained strong. The rising trend of new contract rent continued.
- The **vacancy rate*** was 0.87%, up 0.06 points from the previous quarter. In terms of the **increase and decrease in vacancies***, the increase exceeded the decrease for the first time in 18 quarters, with 63,000 tsubo increasing and 60,000 tsubo decreasing. The **vacancy turnover ratio***, the rate of decrease in vacant office stock, dropped 2.9 points from the previous quarter to 50.7%.

* The calculation method has been changed from that of the previous quarter. Details are provided at the end of the report.
- The **new contract rent index**, the level of new lease rent, was 127, +4 from the previous quarter. The **contract rent diffusion index**, calculated by subtracting the percentage of buildings with a new rent decrease from that of buildings with a new rent increase, remained above zero for the seventeenth consecutive quarter at +34.
- The **paying rent index**, which includes new and existing rents, was 96, +2 from the previous quarter.
- The **average free rent months of lease with free rent** was 1.7 months and ratio of free rent granted was 47.3%, indicating that free rent has become common in the market.

Figure 1: Vacancy Rate (by Area)



Vacancy

Figure 1 is the **vacancy rate** in Tokyo 23 Wards, five Central Wards (Chuo, Chiyoda, Minato, Shibuya, and Shinjuku Wards), and 18 Peripheral Wards since 2011. The rate in Q2 2019 rose 0.06 points in the 23 Wards to 0.87%, 0.04 points in the five Central Wards to 0.59%, and 0.12 points in the 18 Peripheral Wards to 1.77%. Although companies still have large needs to expand offices,^{*1} they are having difficulty expanding even if their headcount has increased and their offices have become small, due to lack of offices of the required size and location. As a result, an increasing number of companies are seeking to solve their office size constraints with work-from-home and telework. This can be considered as a reason why the vacancy rate did not drop.

^{*1} Metropolitan Areas Office Demand Survey Spring 2019, released on June 26, 2019

<https://www.xymax.co.jp/english/research/images/pdf/20190626.pdf>

Figure 2: Vacancy Rate (by Size)

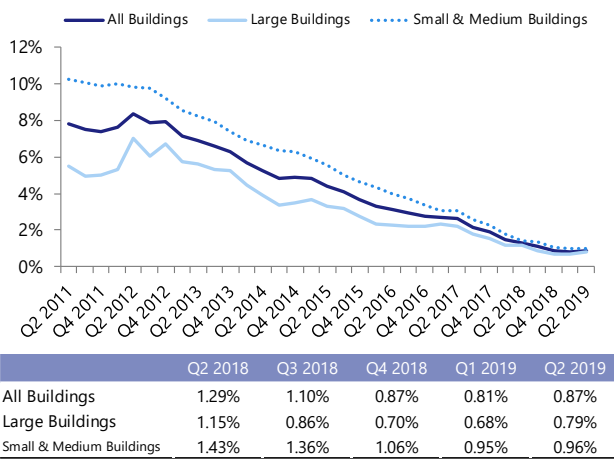


Figure 2 is the **vacancy rate** of all buildings, large buildings (gross floor area (GFA): 5,000 tsubo or more), and small & medium buildings (GFA: less than 5,000 tsubo) since 2011. In Q2 2019, the rate rose quarter on quarter in both large and small & medium buildings, at 0.79% and 0.96%, respectively.

Figure 3: Increase and Decrease in Vacancies (23 Wards, All Sizes)

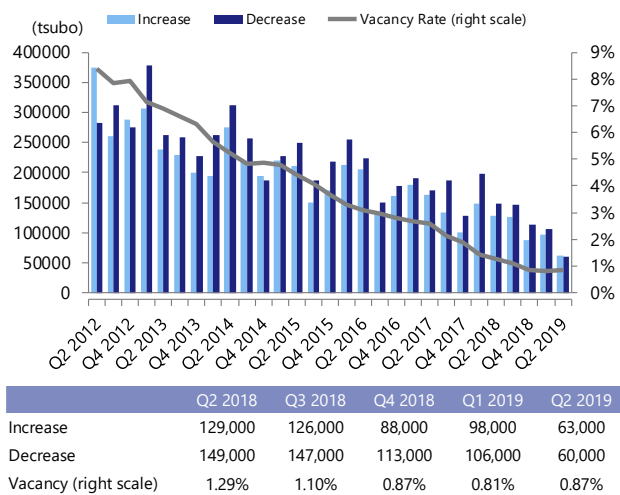


Figure 3 is the **increase and decrease in vacancies**. The increase was 63,000 tsubo and the decrease was 60,000 tsubo, both all-time lows, in Q2 2019. The increase exceeded the decrease for the first time in 18 quarters.

Reasons for the all-time low of increase and decrease in vacancies include the continued strong scarcity of vacancies in the overall market, with the vacancy rate less than 1%, and the small supply of new office building completions in Q2 2019.

Figure 4: Vacancy Turnover Ratio (4-quarter moving average)

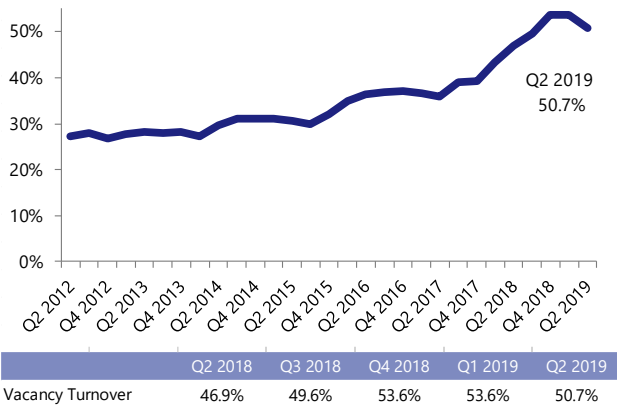


Figure 4 shows the **vacancy turnover ratio (four-quarter moving average)**, the rate of vacancies leased to tenants during the quarter to all the vacant office stock (vacancies at the start of the quarter + vacancies added during the quarter). Although the ratio in Q2 2019 was 50.7%, down 2.9 points from the previous quarter, the ratio remains high. Vacancy turnover in the office market still seems to be active.

Figure 5: New Contract Rent Index



New Contract Rent

Figure 5 is the **new contract rent index**, the index of new lease rent levels. The index for Q2 2019 was 127, up 4 points from the previous quarter and up 14 points year on year. The rising trend of new rent since Q2 2012 has continued. Large office buildings with good access continue to be popular for purposes such as consolidation of offices for greater work efficiency. Due to the shortage of vacancies in the market, there were cases where the borrower side accepted the lender side’s aggressive offer of expensive rent.

Figure 6: New Contract Rent Index (by Size)

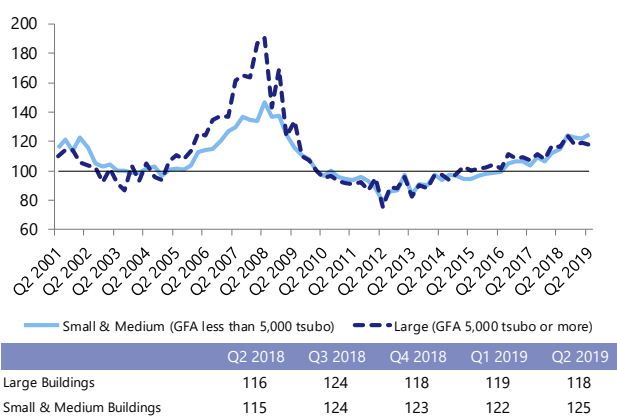


Figure 6 shows the new contract rent index **by size of building**. The index for large buildings with a GFA of 5,000 tsubo or more dropped 1 point to 118. The index for small & medium buildings with a GFA of less than 5,000 tsubo rose 3 points from the previous quarter to 125. The rising trend since 2012 has continued in both sizes of buildings.

Figure 7: Contract Rent DI

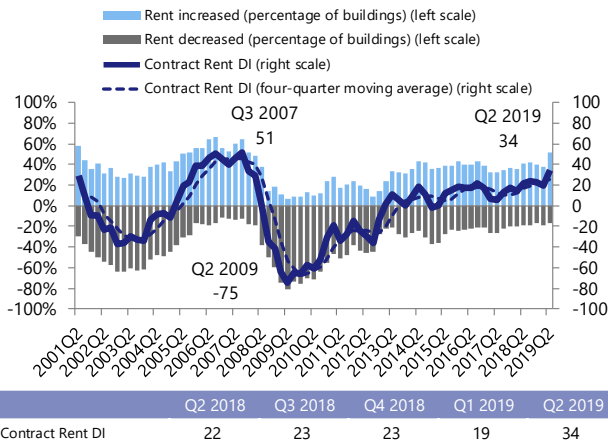


Figure 7 is the **contract rent diffusion index (DI)** (the percentage of buildings with rent rises minus the percentage of buildings with rent declines), which indicates the direction of changes in new lease rents. The DI in Q2 2019 was +34, up 15 points from the previous quarter. This indicates that there were more buildings with a higher rent than six months ago than those with a lower rent. The DI remained above zero for 17 consecutive quarters.

Paying Rent

Figure 8 shows the **paying rent index**, which covers both new lease rents and existing lease rents. The index in Q2 2019 was 96, up 2 points from the previous quarter. More lenders are aggressively raising rent upon renewal of contract on the back of a shortage in vacancies in the market and a rise in new rent. Borrowers also tend to accept a certain degree of rent rise negotiations since there are limited options for relocation and the rent of offices after relocation is also high. This is thought to have led to the rise in the paying rent index.

Figure 8: Paying Rent Index

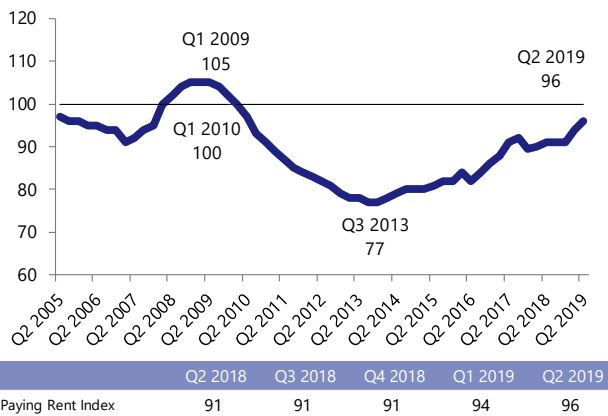
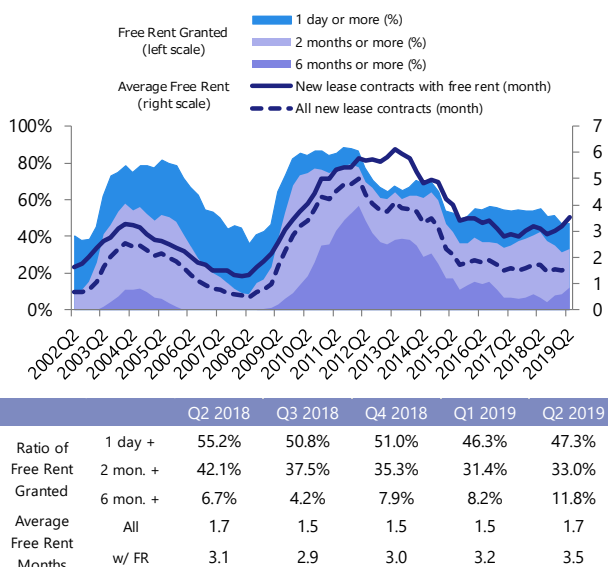


Figure 9: Free Rent



Free Rent

Figure 9 indicates the percentage 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 months**). In Q2 2019, the average free rent months were 3.5 months for leases with free rent, a slight increase of 0.3 months from Q1 2019, and 1.7 months for all new leases, an increase of 0.2 months from the previous quarter.

As in Q1 2019, there is a certain amount of free rent, both long-term and short-term, indicating that the custom of granting free rent has spread across the market. As rent levels have also continued to rise, relatively long-term free rent is also granted in some cases as a result of negotiations.

Figure 10: Market Cycle



Market Cycle

Figure 10 plots the vacancy rate on the horizontal axis and the new contract rent index on the vertical axis on a quarterly basis. It shows the cyclical nature 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 office rental market entered a recovery phase in 2013, with the trend continuing in Q1 2019. During Q2 2019, the chart moved to the upper right due to rises in both vacancy rate and rent.

Changes in the calculation method related to the vacancy rate

In order to better reflect the supply and demand balance of the office market in vacancy-related indicators (vacancy rate, increase and decrease in vacancies, vacancy turnover ratio), we reviewed the criteria for the targets of calculation and carried out a recalculation, including past data. We will apply the changes starting from *Office Market Report Tokyo Q1 2019*, released on May 8, 2019, but will not replace the reports we have released in the past.

The data that we have recalculated retrospectively can be found in our website (please refer to the URL below). Those who are using the time series data for the vacancy rate, increase and decrease in vacancies, vacancy turnover ratio, and market cycle (Figures 1–4 and 10) are requested to replace the data.

* The data after the changes can be found below.

https://soken.xymax.co.jp/wp-content/uploads/2019/07/1908-office_market_report_q2_2019_data.xlsx

Reference

Figure 11: Major Building Completions (Q2 2019)

Name	Floors		Ward	Address	Completion	Total floor area (tsubo)
	Above Ground /	Below Ground				
Nihonbashi F Business Cube	10/0		Chuo	15-14 Nihonbashi Kodenma-cho	2019/04	1,435
PARKWAY SQUARE 3	7/1		Shibuya	1-16-8 Jinnan	2019/04	1,459
Sumitomo RD Shiba Daimon 2-Chome Building	14/1		Minato	2-11-8 Shiba Daimon	2019/05	2,598
PMO Shinjuku Gyoen-mae	9/3		Shinjuku	2-1-12 Shinjuku	2019/05	1,326

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

Figure 12: Major Office Relocations (Q2 2019)

Company	From	To	Month Year	Purpose	Size (tsubo)
Yamato Scientific	Muromachi Higashi Mitsui Building <i>Chuo Ward</i>	Harumi Triton Square Office Tower Y <i>Chuo Ward</i>	Jul 2019	Greater efficiency	641
TF Payment Service	Nishi-Shinjuku KS Building <i>Shinjuku Ward</i>	Shinagawa HEART <i>Minato Ward</i>	Summer of 2019	Expansion	330
Daiko Advertising	Akasaka Park Building <i>Minato Ward</i>	Orix Shiba 2-Chome Building <i>Minato Ward</i>	Oct 2019	Integration	1,955
Takachiho Koheki	Nakamura Building <i>Shinjuku Ward</i>	YOTSUYA TOWER <i>Shinjuku Ward</i>	May 2020	Greater efficiency	650
JX Nippon Mining & Metals	Otemon Tower JX Building <i>Chiyoda Ward</i>	The Okura Prestige Tower <i>Minato Ward</i>	Jun 2020	Greater efficiency	2,754

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	GFA 300 tsubo or more	GFA 300 tsubo or more	GFA 300 tsubo or more	GFA 300 tsubo or more
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	8,475 buildings	4,287 contracts	4,287 contracts	644 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		
Market	Tokyo 23 Wards		
Building Size	All	GFA 300 tsubo or more	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	1,023 contracts	3,946 contracts	279 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 – July 2019)

Energy Consumption and Energy Cost in Office Buildings May 15, 2019

- This report is a summary of the results of a survey of energy consumption and energy cost in office buildings in the Greater Tokyo area.

Effect of Commuting Stress on the Working People's Satisfaction June 4, 2019

- This report is a summary of the results of a survey of the effect of commuting stress on office workers, with a focus on the reality of commute of workers in the Greater Tokyo area.

Metropolitan Areas Office Demand Survey Spring 2019 June 26, 2019

- This report is a summary of the results of a continuous analysis of the relationship between office demand and the actual state of companies' office use and workstyles, on which we conduct a questionnaire survey biannually.

Please contact below for inquiries on this report

Xymax Real Estate Institute
<https://soken.xymax.co.jp>
E-MAIL: info-rei@xymax.co.jp