

Office Market Report

Tokyo | Q3 2019

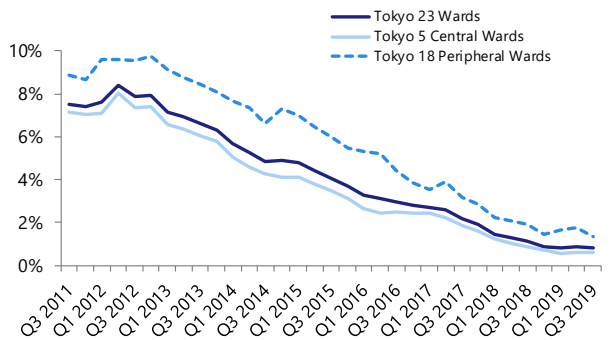
November 6, 2019



Summary

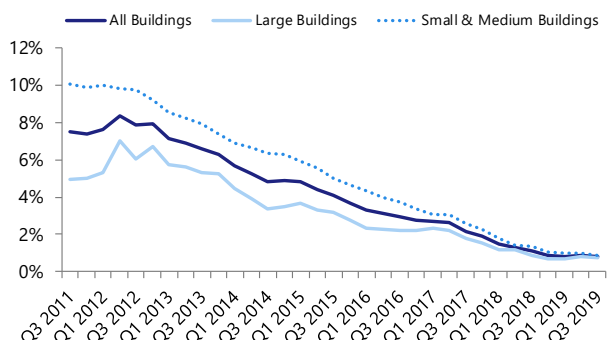
- In Q3 (July–September) 2019, the Tokyo 23 Wards' office market saw a drop in vacancy rate for the first time in two quarters as demand for office space remained strong and existing vacancies were filled promptly. The rising trend of new contract rent has continued.
- The **vacancy rate** was 0.79%, down 0.08 points from the previous quarter. In terms of the **increase and decrease in vacancies**, the decrease exceeded the increase for the first time in two quarters, as 77,000 tsubo (1 tsubo = 3.3 sqm) increased and 86,000 tsubo decreased. The **vacancy turnover ratio**, the rate of decrease in vacant office stock, dropped 1.0 point from the previous quarter to 49.7%.
- The **new contract rent index**, the level of new lease rent, was 135, +8 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 eighteenth consecutive quarter at +40.
- The **paying rent index**, which includes both new and existing rents, was 98, +2 from the previous quarter.
- The **average free rent months of lease with free rent** was 1.6 months and ratio of free rent offered was 45.9%, indicating that free rent has become common in the market.

Figure 1: Vacancy Rate (by Area)



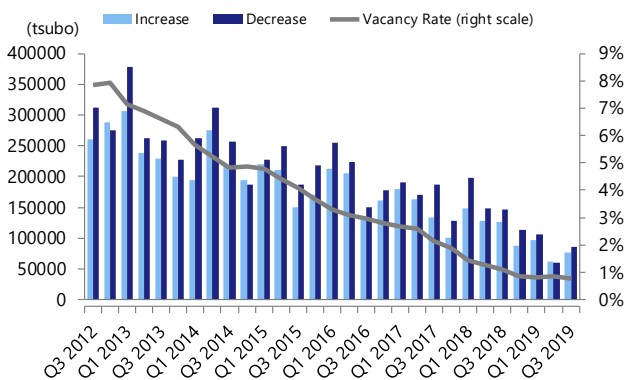
	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019
Tokyo 23 Wards	1.10%	0.87%	0.81%	0.87%	0.79%
Tokyo 5 Central Wards	0.84%	0.69%	0.55%	0.59%	0.62%
Tokyo 18 Peripheral Wards	1.92%	1.46%	1.65%	1.77%	1.36%

Figure 2: Vacancy Rate (by Size)



	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019
All Buildings	1.10%	0.87%	0.81%	0.87%	0.79%
Large Buildings	0.86%	0.70%	0.68%	0.79%	0.73%
Small & Medium Buildings	1.36%	1.06%	0.95%	0.96%	0.86%

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



	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019
Increase	126,000	88,000	98,000	63,000	77,000
Decrease	147,000	113,000	106,000	60,000	86,000
Vacancy (right scale)	1.10%	0.87%	0.81%	0.87%	0.79%

Vacancy

Figure 1 shows the **vacancy rates** in the Tokyo 23 Wards, five Central Wards (Chuo, Chiyoda, Minato, Shibuya, and Shinjuku Wards), and 18 Peripheral Wards since 2011. The rate in Q3 2019 dropped 0.08 points in the 23 Wards to 0.79%, rose 0.03 points in the five Central Wards to 0.62%, and dropped 0.41 points in the 18 Peripheral Wards to 1.36%. Companies' needs for expanding their offices remains high, leading to record low vacancy rates in the 23 Wards and the 18 Peripheral Wards.

The reasons for the drop in vacancy rates include demand for office space regardless of location or age and formerly occupied spaces being filled from within the building without going on the market.

Figure 2 is the **vacancy rates** of all sizes of buildings, large buildings (gross floor area (GFA): 5,000 tsubo or more), and small & medium buildings (GFA: less than 5,000 tsubo) in the Tokyo 23 Wards since 2011. In Q3 2019, the rate dropped in both large buildings and small & medium buildings quarter on quarter by 0.06 points and 0.1 points to 0.73% and 0.86%, respectively.

Figure 3 shows the **increase and decrease in vacancies**. The increase was 77,000 tsubo and the decrease was 86,000 tsubo in Q3 2019. The decrease exceeded the increase for the first time in two quarters, as vacancies of existing properties were also promptly filled.

Both increases and decreases in vacancies were larger than the previous quarter as several large office buildings were completed in Q3 2019 and were fully occupied at the time of completion.

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

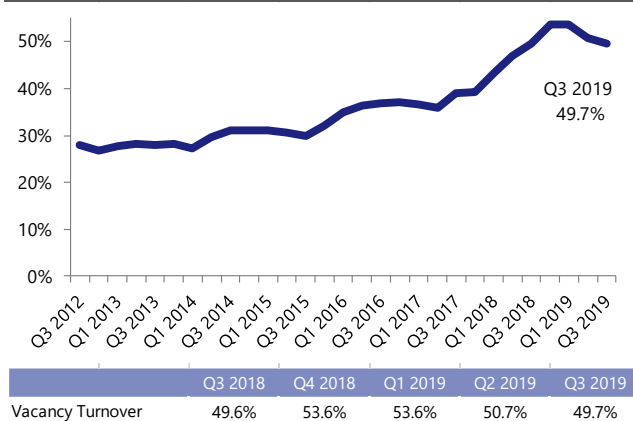


Figure 4 shows the **vacancy turnover ratio (four-quarter moving average)**, the rate of vacancies leased to tenants during the quarter to all the vacant office stock (vacant office stock at the start of the quarter + vacancies added during the quarter). Although the ratio in Q3 2019 was down 1.0 point quarter on quarter to 49.7%, it remains at a high level. With the ratio trending at around 50% over the past year, 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 Q3 2019 was 135, up 8 points from the previous quarter and up 13 points year on year. New rent has been rising since Q2 2012. Due to an extremely low vacancy rate in the Tokyo 23 Wards and a shortage of vacant office stock in the market, some borrowers even offered to pay a level of rent that was higher than the asking price to secure office space for which several tenants had applied to rent.

Figure 6: New Contract Rent Index (by Size)

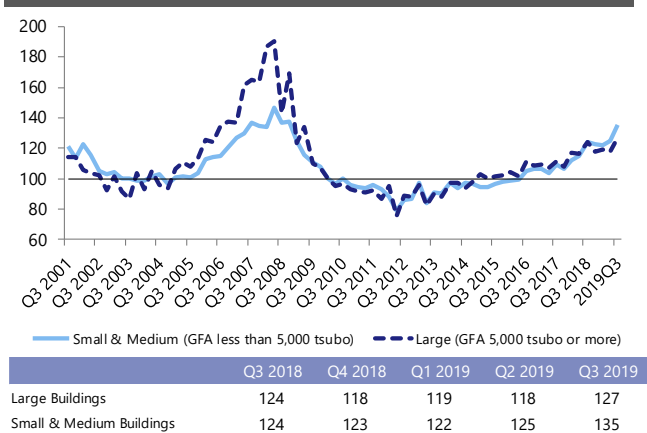


Figure 6 shows the new contract rent index **by size of building**. The index for large buildings with a GFA of 5,000 tsubo or more rose 9 points to 127, while that for small & medium buildings with a GFA of less than 5,000 tsubo rose 10 points from the previous quarter to 135. The rising trend since Q2 2012 has continued in both sizes of buildings.

Figure 7: Contract Rent DI

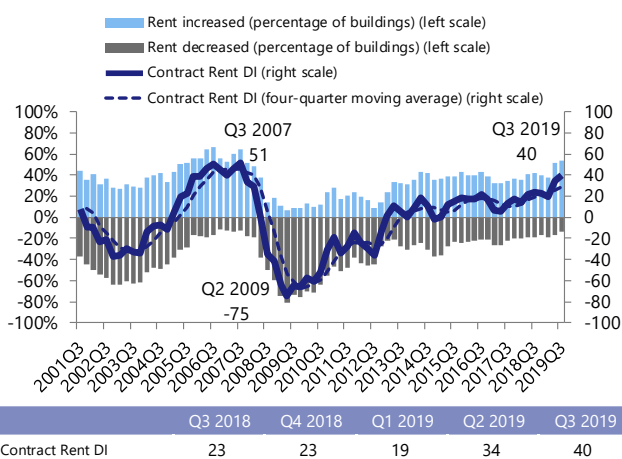
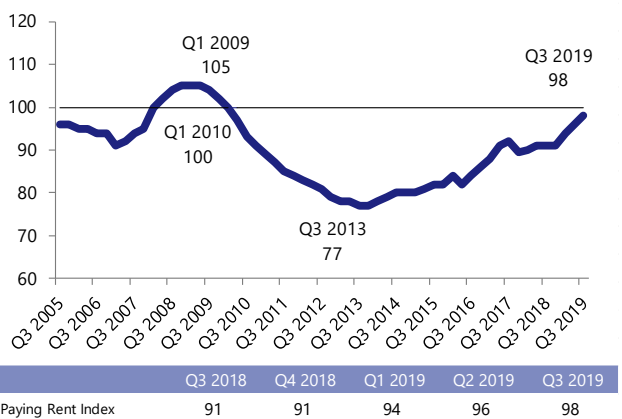


Figure 7 is the **contract rent diffusion index (DI)** (the percentage of buildings with rent rises minus the percentage of buildings with rent declines), which indicates the direction of changes in new contract rents. The DI in Q3 2019 was +40, up 6 points from the previous quarter. This indicates that there were more buildings with a higher new rent from six months ago than those with a lower rent. The DI has remained above zero for 18 consecutive quarters.

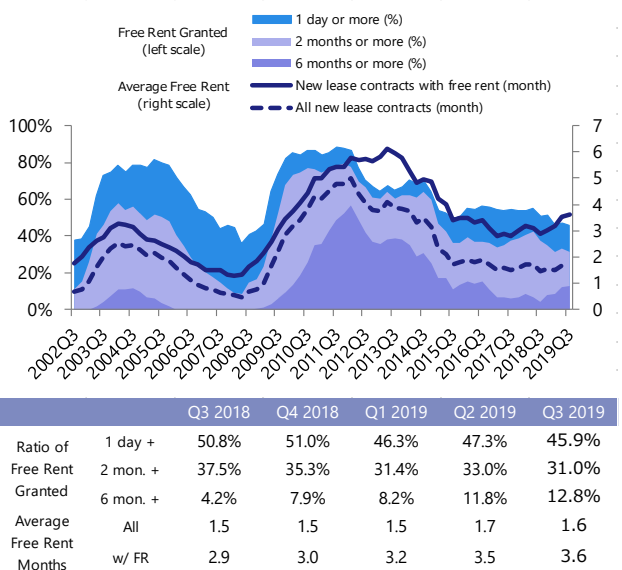
Figure 8: Paying Rent Index



Paying Rent

Figure 8 shows the **paying rent index**, which includes both new lease rents and existing lease rents. The index in Q3 2019 was 98, up 2 points from Q2 2019 and up 7 points year on year. The upward trend since Q3 2013 has continued. There continue to be many lenders that aggressively raise rent when the contract is renewed on the back of a shortage of vacancies in the market and rises in new rent.

Figure 9: Free Rent

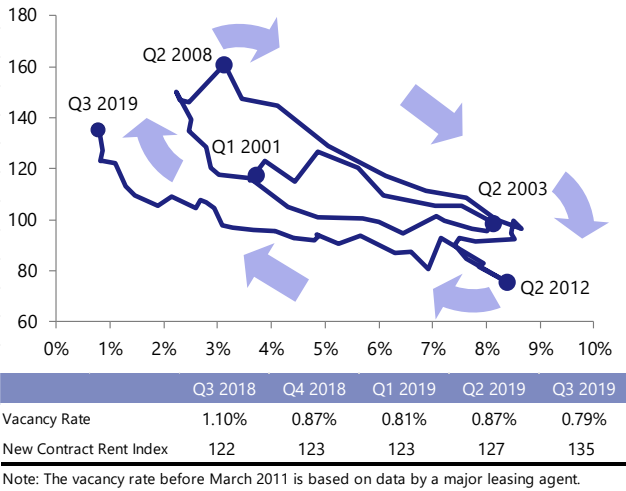


Free Rent

Figure 9 indicates the percentage of new lease contracts with free rent to all new lease contracts (**ratio of free rent offered**) and the average free rent period (**average free rent months**). In Q3 2019, the average free rent months were 3.6 months for leases with free rent, an increase of 0.1 months from Q2 2019, and 1.6 months for all new leases, 0.1 months shorter than the previous quarter.

The ratio of free rent offered, which had been dropping since 2011, has remained flat since around 2016, indicating that the custom of offering free rent has spread across the market. Furthermore, as rent levels have continued to rise, some lessors offer free rent for a relatively long period of time 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 cyclicity of the market, with the chart trending to the lower right in 2001 (vacancy up, rent down), remaining flat 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 Q3 2019. The chart moved to the upper left due to a mild drop in the vacancy rate and a rise in rent.

Reference

Figure 11: Major Building Completions (Q3 2019)

Name	Floors		Ward	Address	Completion	Total floor area (tsubo)
	Above Ground /	Below Ground				
The Okura Prestige Tower	41/1		Minato	2-10-4 Toranomom	2019/07	46,283
Sumitomo Fudosan Shinjuku Central Park Tower	33/2		Shinjuku	6-18-1 Nishi-Shinjuku	2019/08	18,307
Link Square Shinjuku	16/2		Shibuya	5-27-5 Sendagaya	2019/08	13,237
Sumitomo Fudosan Akihabara Ekimae Bldg.	21/2		Chiyoda	4-2 Kanda Neribeicho	2019/08	9,317
Shibuya Scramble Square East Bldg.	47/7		Shibuya	2-24-12 Shibuya	2019/08	54,753

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

Figure 12: Major Office Relocations (Q3 2019)

Company	From	To	Month Year	Purpose	Size (tsubo)
OKWAVE	Unosawa Tokyu Bldg. <i>Shibuya Ward</i>	Toranomon Towers Office <i>Minato Ward</i>	Jan. 2020	Greater efficiency	464
Nippon Dry-Chemical	Trade Peer Odaiba <i>Minato Ward</i>	Tabata ASUKA Tower <i>Kita Ward</i>	Feb. 2020	Greater efficiency	650
Scala	Ebisu Prime Square Tower <i>Shibuya Ward</i>	Shibuya Hikarie <i>Shibuya Ward</i>	Feb. 2020	Floor consolidation	380
Japan Tobacco	JT Bldg. <i>Minato Ward</i>	Kamiyacho Trust Tower <i>Minato Ward</i>	Jan. 2021	Greater efficiency	5,800

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	8,496 buildings	4,286 contracts	4,286 contracts	520 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	647 contracts	4,078 contracts	281 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 (August – October 2019)

Compilation of Best Practices of Small & Medium-sized Buildings (1) September 24, 2019

- This report is a compilation of best practices, or examples of prominent initiatives, collected through questionnaires and interviews with owners of small and medium-sized buildings who lease out their buildings.

Real Trends of Real Estate 2020 September 30, 2019

- This report features themes that are considered important in the society that surrounds us and examines their situations and impact on real estate.

Office Space per Person (2019) October 2, 2019

- This report is a summary of the results of a continuous survey of tenant companies of office buildings on the leased area per user at tenants of general offices, for the purpose of understanding companies' actual use of offices.

The Effectiveness of Setting Up a Workplace Other than in Central Tokyo October 4, 2019

- This report examines the effectiveness of having several workplace options mainly from the perspective of location (central Tokyo vs periphery).

Please contact below for inquiries on this report

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