

# Office Market Report

Tokyo | Q3 2020

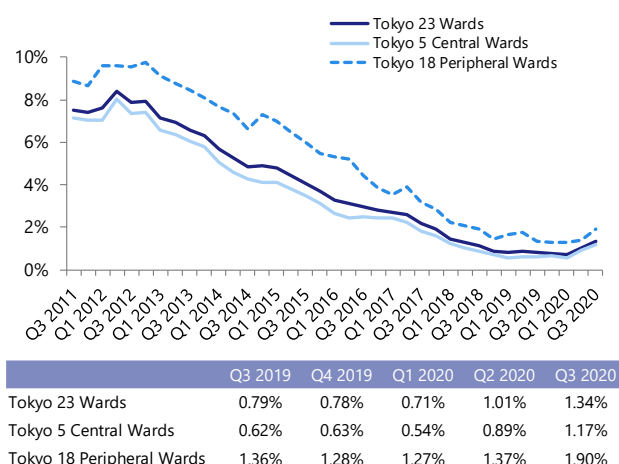
November 4, 2020



## Summary

- In Q3 (July–September) 2020, the office market of the 23 wards of Tokyo (“Tokyo 23 Wards”) showed clearer signs of change as demand for office space weakened and vacancy rates rose further.
- The **vacancy rate** was 1.34%, up 0.33 percentage points from the previous quarter. The **increase and decrease in vacant space** showed that vacant space increased by 102,000 tsubo (1 tsubo = approx. 3.3 sqm) and decreased by 65,000 tsubo. The increase in vacant space outweighed the decrease in vacant space for the second consecutive quarter. The **vacancy turnover ratio**, which is the rate of decrease of vacant office stock, dropped 14.0 percentage points quarter on quarter to 32.4%.
- The **new contract rent index**, the level of new lease rent, was 132, up 4 points from the previous quarter. The **contract rent diffusion index**, which is the percentage of buildings with a rise in new rent minus that of buildings with a drop in new rent, declined by 5 points from the previous quarter to +13.
- The **paying rent index**, which includes both new and existing rents, was 105, up 2 points quarter on quarter.
- The **average free rent months of lease with free rent** was unchanged from the previous quarter at 0.9 months. The ratio of free rent offered was 33.8%, down 0.5 percentage points.
- **TOPIC: The availability rate**, which takes into account the available space for which a notice of cancellation has been given but from which the tenant has not yet vacated in addition to the currently vacant space, has risen sharply regardless of the area or size of the building. The rate is currently 3.42% in Tokyo 23 Wards.

Figure 1: Vacancy Rate (by Area)



## Vacancy

Figure 1 shows the **vacancy rates** in Tokyo 23 Wards, the 5 Central Wards (Chuo, Chiyoda, Minato, Shibuya, and Shinjuku Wards), and the 18 Peripheral Wards since 2011. The rate in Q3 2020 rose by 0.33 points from Q2 to 1.34% in the 23 Wards, by 0.28 points to 1.17% in the 5 Central Wards, and by 0.53 points to 1.90% in the 18 Peripheral Wards. The vacancy rate rose in all three areas for the second consecutive quarter due to a continued fall in companies' office expansion needs.

Factors for the rise in vacancy rates include companies increasingly reviewing their office space following a reconsideration of their recruitment plans or the spread of telework due to the impact of COVID-19, preventing vacancies in the market to be filled.

Figure 2: Vacancy Rate (by Size)

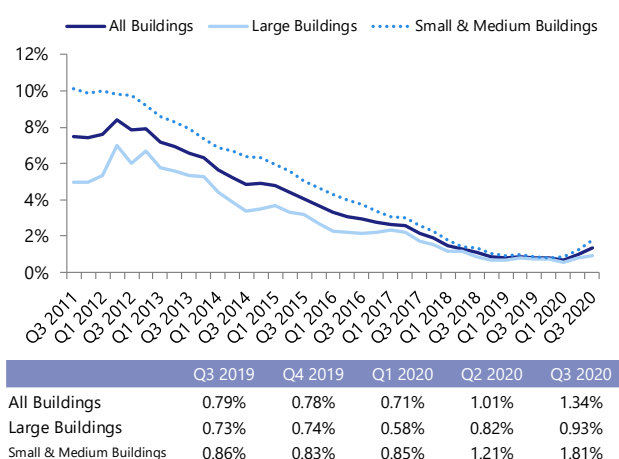


Figure 2 shows the **vacancy rates** of all sizes of buildings, large buildings (gross floor area (GFA): 5,000 tsubo or more), and small & medium buildings (GFA: less than 5,000 tsubo) in Tokyo 23 Wards since 2011. In Q3 2020, the vacancy rate rose by 0.11 points to 0.93% among large buildings and by 0.60 points to 1.81% among small & medium buildings.

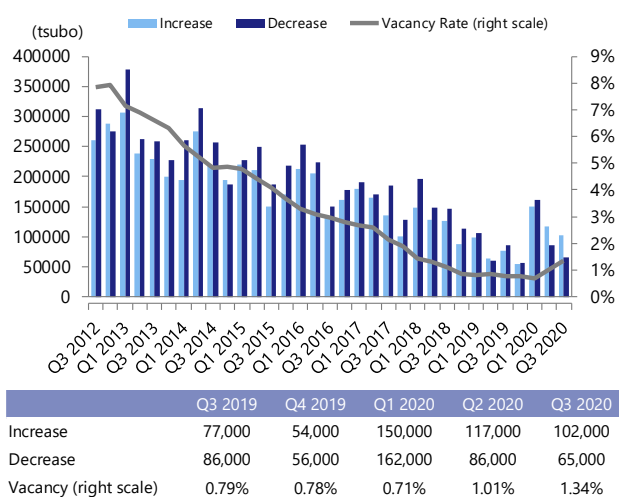
Figure 3: Increase and Decrease in Vacant Space  
(23 Wards, All Sizes)

Figure 3 is the **increase and decrease in vacant space**. In Q3 2020, the increase in vacant space was 102,000 tsubo, while the decrease was 65,000 tsubo. The difference between the increased vacant space and decreased space has widened, with the increase exceeding the decrease for the second consecutive quarter. Unlike the "pre-COVID19" period up to Q1 2020, there seems to be a rise in difficulty finding a new tenant for vacant space after the previous tenant has relocated.

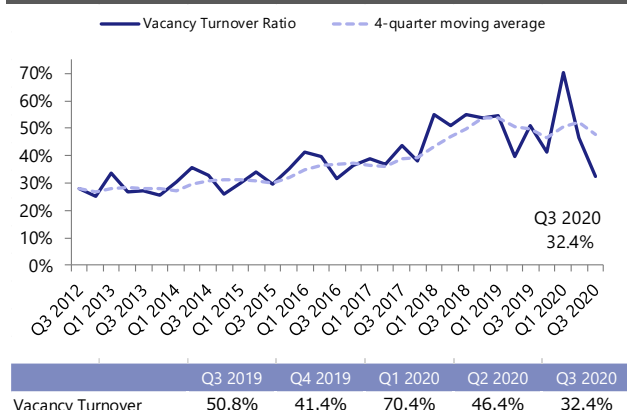
**Figure 4: Vacancy Turnover Ratio**


Figure 4 shows the **vacancy turnover ratio**, the ratio of vacant spaces leased to tenants during the quarter to the total vacant office stock (vacant office stock at start of quarter + vacant space added during the quarter). The ratio in Q3 2020 dropped by 14.0 points from Q2 and by as much as 38.0 points from Q1 to 32.4%. This level is equivalent to that in Q3 2016 (31.6%), which marks a major shift in the market.

## New Contract Rent

Figure 5 is the **new contract rent index**, which is the rent level for new lease contracts. The index for Q3 2020 was 132, up 4 points from Q2 and down 3 points from Q3 2019. New contract rent, which has continued to rise since Q2 2012, is showing signs of peaking out and may be flattening or starting to decline. Although more companies are being cautious in relocating or expanding their offices on the back of continued uncertainties in the economic outlook, this has not led to a significant drop in rent, most likely due to vacancy rates remaining low.

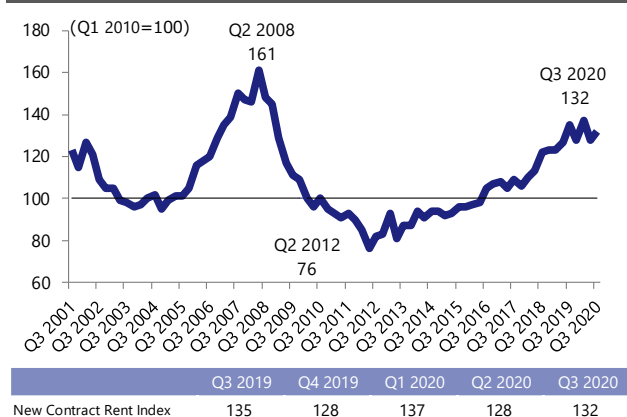
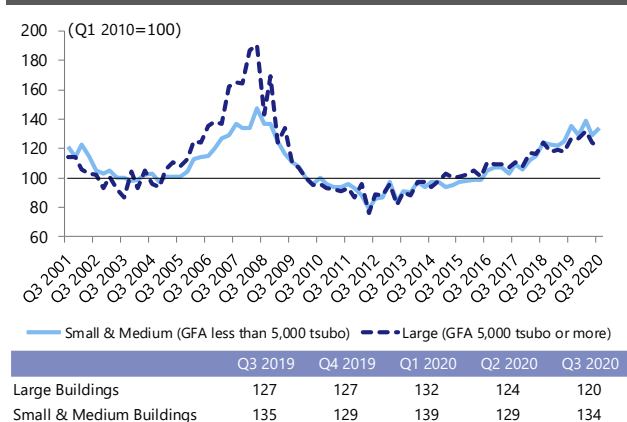
**Figure 5: New Contract Rent Index**

**Figure 6: New Contract Rent Index (by Size)**


Figure 6 is the new contract rent index by **size of building**. The index for large companies with a GFA of 5,000 tsubo or more dropped by 4 points from Q2 to 120, while that for small & medium buildings with a GFA of less than 5,000 tsubo rose by 5 points to 134. Both figures are below the figures for Q1 2020, the peak of the past several years.

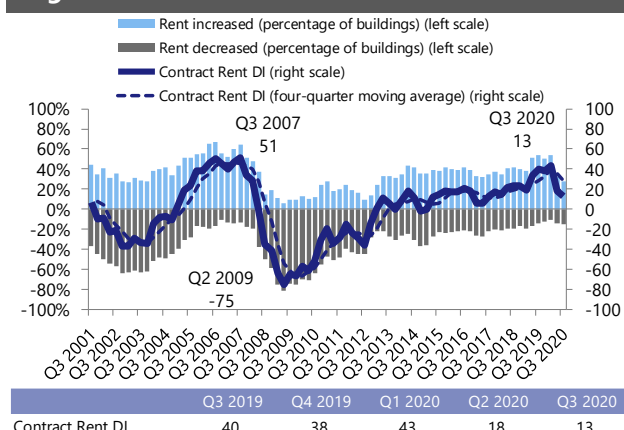
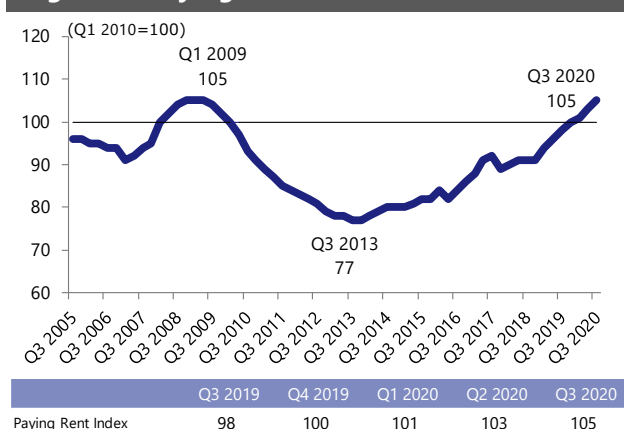
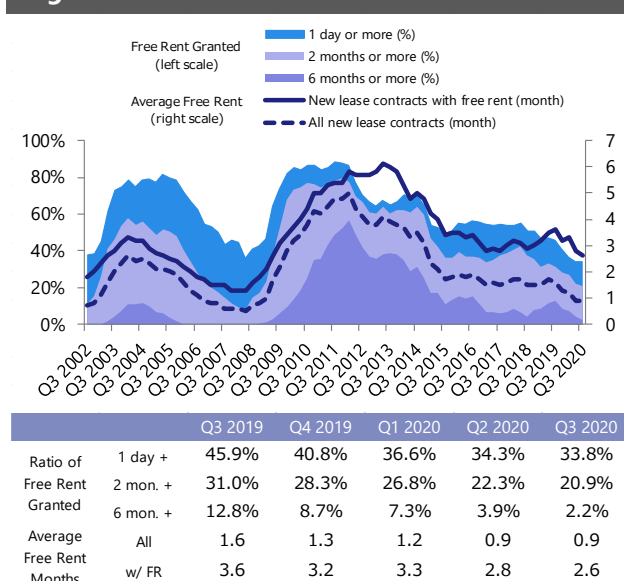
**Figure 7: Contract Rent DI**


Figure 7 is the **contract rent diffusion index (DI)** (the percentage of buildings with a rent rise minus that of buildings with a rent decline), which indicates the direction of changes in new contract rent. The DI in Q3 2020 was +13. This is the 22nd consecutive quarter in which the index was above zero, which indicates that there were more buildings with higher new rent than six months ago than those with lower new rent. However, the index fell by 5 points when compared to Q2. The percentage of buildings with a drop in rent has been rising gradually since Q1 2020.

**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 2020 was 105, up 2 points quarter on quarter and up 7 points year on year. The upward trend since Q3 2013 has continued. One of the factors for the rise is that negotiations for a rent rise were carried out with tenants who took out the lease when rent levels were low. However, future developments must be monitored carefully since paying rent tend to change more slowly than new contract rent.

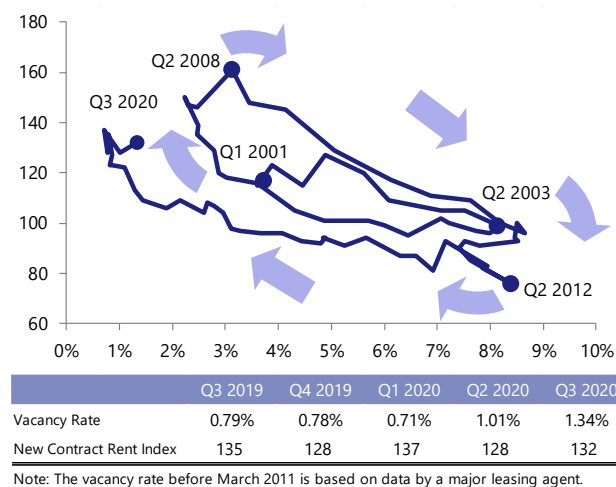
**Figure 9: Free Rent**


## Free Rent

Figure 9 is 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 2020, the average free rent months was 2.6 among lease contracts with free rent, 0.2 months less than in Q2, and 0.9 months among all new contracts, unchanged from Q2.

The ratio of free rent offered has remained flat since around 2016 after having dropped since 2011, indicating that offering free rent has become common across the market. In Q3 2020, the ratio of free rent offered dropped, while average free rent months was unchanged or declined.



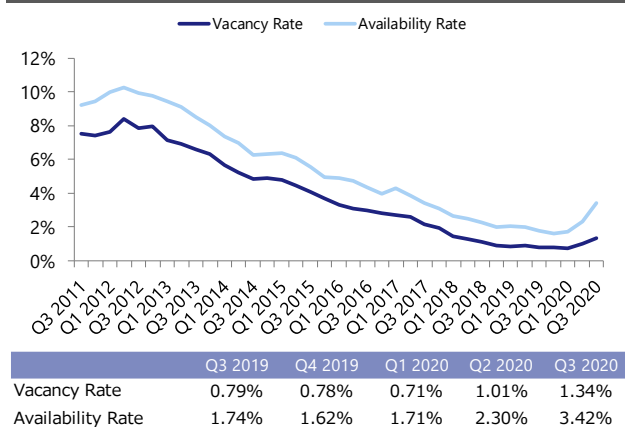
**Figure 10: Market Cycle**


## Market Cycle

Figure 10 plots the vacancy rate on the horizontal scale and the new contract rent index on the vertical scale 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 sluggish between 2003 and 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).

Although the office lease market had been in a recovery phase since 2013, the chart trended to the upper right as both vacancy rates and the new contract rent index rose in Q3 2020.

## TOPIC

**Figure 11: Availability Rate and Vacancy Rate**


## Vacancy Rate on an Availability Basis (Availability Rate)

The vacancy rate and the increase and decrease in vacant space, which we have examined above, cover vacancies from which the tenant has already vacated and are available for immediate occupancy (currently vacant). To analyze the changes in the market in more detail, we created the **availability rate**, which adds the vacant space for which a notice of cancellation has been given and is available (before the previous tenant has left) to currently vacant space.

Figure 11 shows the **availability rate** and the **vacancy rate** of Tokyo 23 Wards since 2011. Although the two had moved roughly in tandem, the availability rate has risen sharply since Q1 2020. While the vacancy rate in Q3 2020 was at the same level as in Q1 2018, the availability rate was at the same level as in Q3 2017.

We believe the background to this is the difficulty in filling vacancies from within the building or finding a new tenant between the notice of cancellation of the lease and the vacating of the previous tenant.

Figure 12: Availability Rate (by Area)

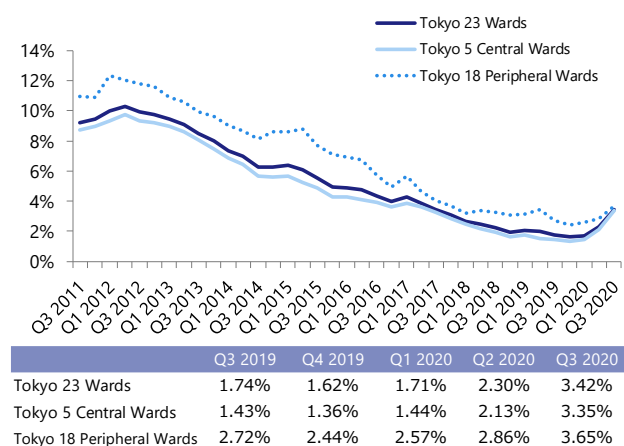


Figure 12 shows the **availability rate** of Tokyo 23 Wards, the 5 Central Wards, and the 18 Peripheral Wards. The rate had remained lower in the 5 Central Wards than in the 18 Peripheral Wards, but has risen to the same level in Q3 2020. While the vacancy rate of the 5 Central Wards remained lower than that of the 18 Peripheral Wards in Q3 2020 as shown in the vacancy rate (by area) of Figure 1, the difference between areas may become smaller going forward.

Figure 13: Availability Rate (by Size)

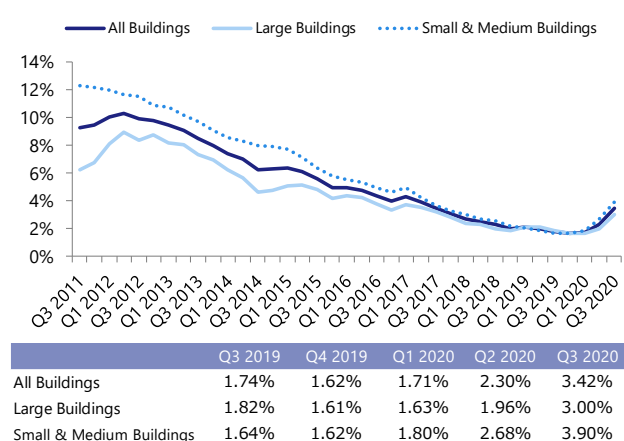


Figure 13 is the **availability rate** of all sizes of buildings, large buildings (GFA: 5,000 tsubo or more), and small & medium buildings (GFA: less than 5,000 tsubo) in Tokyo 23 Wards. The availability rate of large buildings tended to be lower than that of small & medium buildings until around 2017, after which the difference in availability rates between different building sizes became small. This trend has continued even since the rate turned upward in Q1 2020. The availability rate has risen substantially regardless of the size or area of the building. We will continue to monitor the rate closely, as well as other indicators, to see whether this trend will continue in the months to come.

## Reference

**Figure 14: Major Building Completions (Q3 2020)**

Name	Floors	Ward	Address	Completion	Total floor area (tsubo)
	Above ground/ Below ground				
msb Tamachi - Tamachi Station Tower N	36/2	Minato	3-1-1 Shibaura	Jul 2020	46,084
PMO SHIBUYA II	11/1	Shibuya	3-1-1 Shibuya	Aug 2020	1,830
PMO Hamamatsucho II	9	Minato	2-3-6 Shibakoen	Aug 2020	961

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

**Figure 15: Major Office Relocations (Q3 2020)**

Company	From	To	Timing	Purpose	Size (tsubo)
ZENRIN-Datacom CO., LTD.	Shinagawa intercity C <i>Minato Ward</i>	msb Tamachi - Tamachi Station Tower N <i>Minato Ward</i>	Nov 2020	Business expansion	865
Taisei Co., Ltd.	Ohashi Gyoen Eki Bldg. <i>Shinjuku Ward</i>	New Otani Garden Court <i>Chiyoda city</i>	Jan 2021	Increase in personnel	448
PIXTA Inc.	Totate International Building <i>Shibuya Ward</i>	NBF Shibuya East <i>Shibuya Ward</i>	Feb 2021	Greater efficiency	109

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

The sizes of offices are estimates.

Survey Overview				
	Vacancy Rate Availability Rate	Increase and Decrease in Vacant Space	Vacancy Turnover Ratio	New Contract Rent Index
Description	Vacant space and available 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	8,595 buildings	6,445 contracts	6,445 contracts	244 contracts
How to Calculate	<ul style="list-style-type: none"> <li>• Vacancy rate = vacant space ÷ rentable space</li> <li>• Vacant Space Total available vacant space in completed buildings as of the time of the research.</li> <li>• Rentable Space Rentable space of completed buildings as of the time of the research.</li> <li>• Availability rate = available space ÷ rentable space</li> <li>• Available space Total available space, which consist of vacant space and space for which notice of cancellation has been given.</li> </ul> <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"> <li>• Increase in volume of vacant space a. Space in existing buildings formerly occupied by tenants b. Total rentable area of new completions</li> <li>• 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</li> </ul> <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"> <li>• 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.</li> <li>• Volume of vacant space leased during the quarter: Same as the "decrease in volume of vacant space".</li> <li>• Initial vacancy: Total volume of completed buildings that are available for lease as of the start of the quarter.</li> <li>• Vacancy added during the quarter: Same as the "increase in volume of vacant space"</li> </ul>	<p>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.).</p> <p>2) Estimate the quarterly contract rent by assigning the values of a typical building to the model developed in the preceding step.</p> <p>3) The New Contract Rent Index is the rent estimated in the preceding step based on Q1 2010 as the base point (=100).</p> <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	407 contracts	4,121 contracts	63 contracts
How to Calculate	<p>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"</p> <p>2) Calculate the percentage of buildings with "rent decrease" and buildings with "rent increase".</p> <p>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).</p>	<p>1) Calculate the rent per tsubo of each tenant from the data of new and existing lease contracts and memorandums.</p> <p>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.).</p> <p>3) Estimate a quarterly contract rent by assigning the values of a typical building to the model developed in the preceding step.</p> <p>4) The Paying Rent Index is the rent estimated in the preceding step based on Q1 2010 as the base point (=100).</p> <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"> <li>• Free Rent Period The period between the start of the contract and the start of the rent, shown in number of days.</li> <li>• 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)</li> <li>• Average Free Rent (Month) of All the Contracts The simple average of the free rent period including lease contracts with no free rent.</li> <li>• Average Free Rent (Month) of Contracts with Free Rent The simple average of the free rent period of lease contracts with free rent.</li> </ul> <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 2020)

### **Greater Tokyo Company Survey on Work Styles and the Workplace | August 2020    September 18, 2020**

- This report is a summary of the results of a questionnaire survey of companies in Greater Tokyo on the current state and issues of work styles and strategies under the corona crisis.

### **Observations on the Trend of Corporate Relocations    October 14, 2020**

- This report considers the future direction of corporate relocations by identifying the relationship between historical corporate relocation trends and office space market indicators using data of company relocations in Tokyo, which Xymax REI has gathered since the 2000s.

### **Building Owner Survey 2020 (COVID-19 Edition)    October 21, 2020**

- This report is a summary of the results of questions related to COVID-19 within a questionnaire survey of owners of small and medium-sized buildings nationwide who lease out their buildings.

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