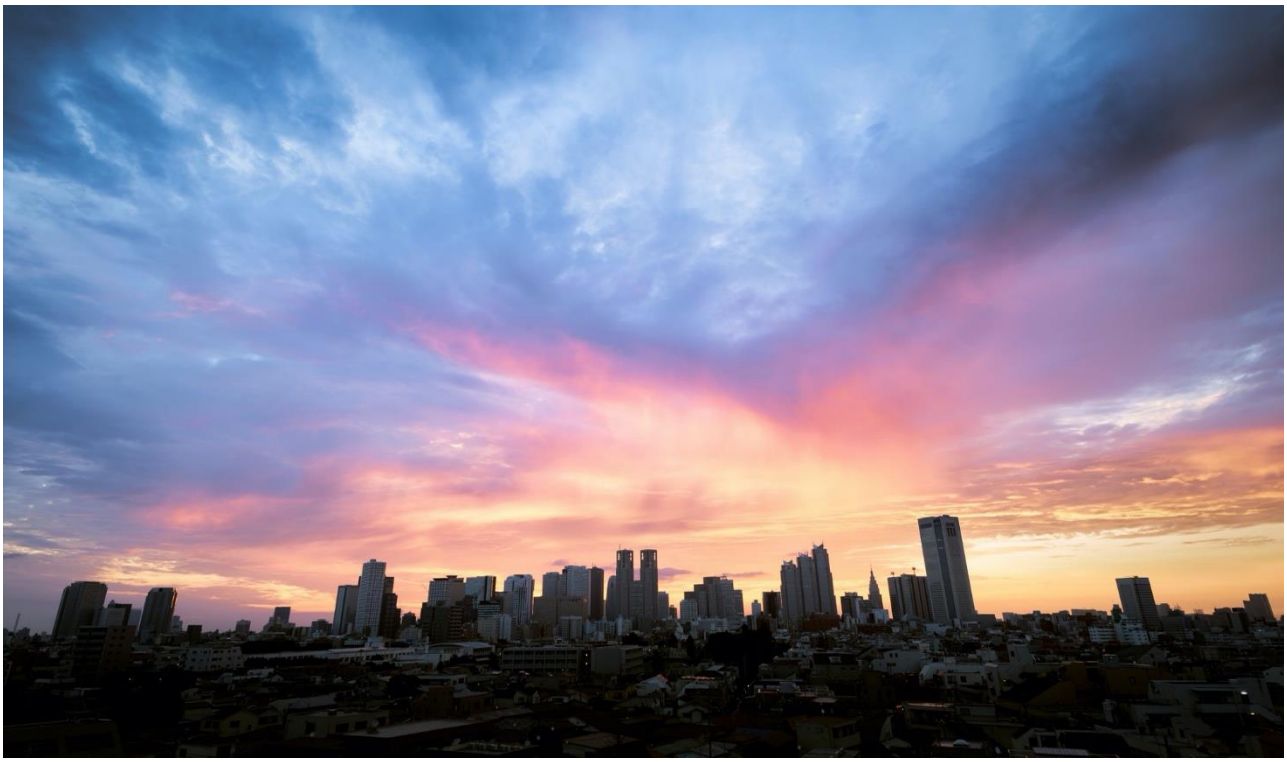
Xymax Real Estate Institute

Office Market Report

Tokyo | Q4 2020

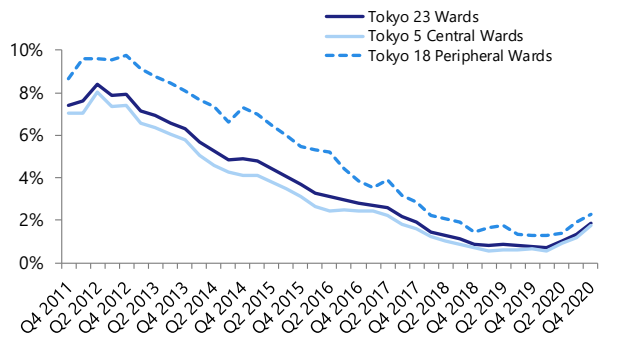
February 3, 2021



Summary

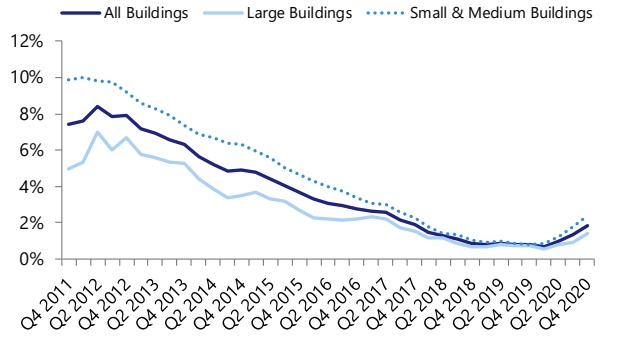
- In Q4 (October–December) 2020, the office market of the 23 wards of Tokyo ("Tokyo 23 Wards") continued to see weak demand for office space as vacancy rates rose and rent levels dropped.
- The **vacancy rate** was 1.87%, up 0.53 percentage points from the previous quarter. The **increase and decrease in vacant space** showed that vacant space increased by 136,000 tsubo (1 tsubo = approx. 3.3 sqm) and decreased by 77,000 tsubo. The increase in vacant space outweighed the decrease for the third consecutive quarter. The **vacancy turnover ratio**, which is the rate of decrease of vacant office stock, dropped 3.4 percentage points quarter on quarter to 26.8%.
- The **new contract rent index**, the level of new lease rent, was 121, down 11 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 35 points from the previous quarter to -22, the first negative figure in 24 quarters.
- The **paying rent index**, which includes both new and existing rents, was unchanged at 105.
- 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 38.2%, up 4.4 percentage points quarter on quarter.

Figure 1: Vacancy Rate (by Area)



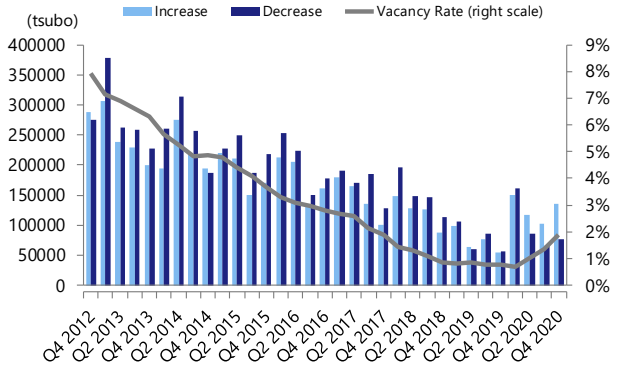
	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
Tokyo 23 Wards	0.78%	0.71%	1.01%	1.34%	1.87%
Tokyo 5 Central Wards	0.63%	0.54%	0.89%	1.17%	1.74%
Tokyo 18 Peripheral Wards	1.28%	1.27%	1.37%	1.90%	2.26%

Figure 2: Vacancy Rate (by Building Size)



	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
All Buildings	0.78%	0.71%	1.01%	1.34%	1.87%
Large Buildings	0.74%	0.58%	0.82%	0.93%	1.39%
Small & Medium Buildings	0.83%	0.85%	1.21%	1.81%	2.40%

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



	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
Increase	54,000	150,000	117,000	102,000	136,000
Decrease	56,000	162,000	86,000	65,000	77,000
Vacancy (right scale)	0.78%	0.71%	1.01%	1.34%	1.87%

Vacancy

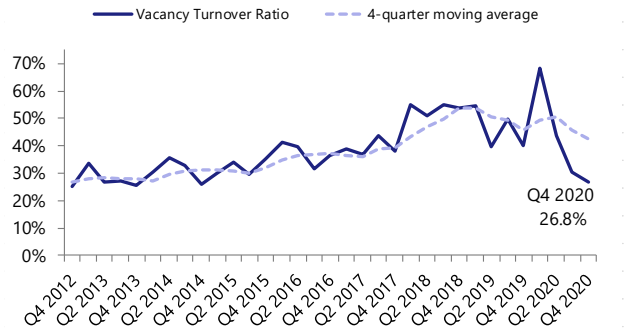
Figure 1 shows the vacancy rates of Tokyo 23 Wards, the 5 Central Wards (Chiyoda, Chuo, Minato, Shinjuku, and Shibuya Wards), and the 18 Peripheral Wards since 2011. The rate in Q4 2020 rose by 0.53 points from Q3 to 1.87% in the 23 Wards, by 0.57 points to 1.74% in the 5 Central Wards, and by 0.36 points to 2.26% in the 18 Peripheral Wards. The vacancy rate rose in all three areas for the third consecutive quarter.

Factors for the rise in vacancy rates include an increase in companies that reduced their office space due to the spread of telework in every business sector as a means to prevent the spread of COVID-19.

Figure 2 shows the **vacancy rate** 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 Q4 2020, the vacancy rate rose by 0.46 points to 1.39% among large buildings and by 0.59 points to 2.40% among small & medium buildings.

Figure 3 is the **increase and decrease in vacant space**. In Q4 2020, the increase in vacant space was 136,000 tsubo, while the decrease was 77,000 tsubo. The difference between the increased vacant space and decreased space has widened, with the increase exceeding the decrease for the third consecutive quarter. The gap widened due to an increase in relocations for downsizing and partial cancellations of lease contracts, despite there being cases where vacant space due to cancellations is filled from within the building.

Figure 4: Vacancy Turnover Ratio

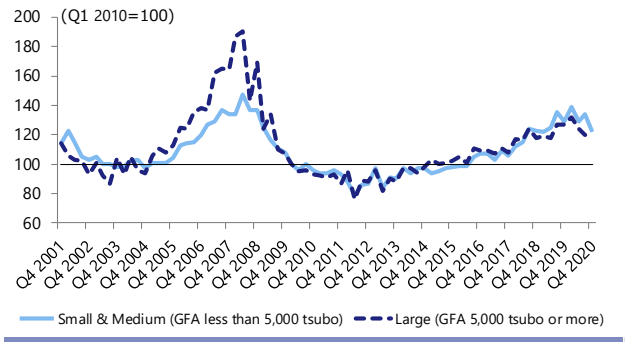


	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
Vacancy Turnover	41.4%	70.4%	46.4%	32.4%	26.8%

Figure 5: New Contract Rent Index

	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
New Contract Rent Index	128	137	128	132	121

Figure 6: New Contract Rent Index (by Size)



	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
Large Buildings	127	132	124	120	120
Small & Medium Buildings	129	139	129	134	122

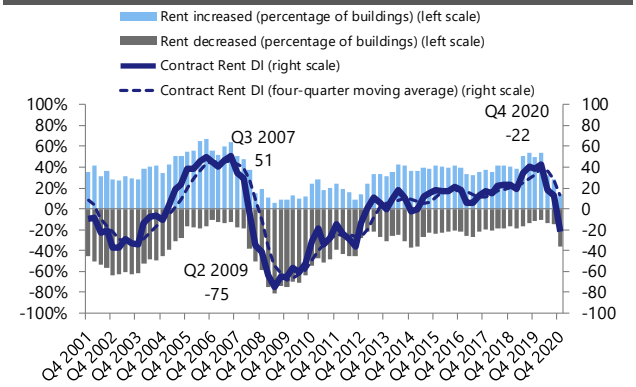
Figure 4 shows the **vacancy turnover ratio**, the ratio of vacant spaces leased to tenants during the quarter to the total vacant office stock (vacant office stock at start of quarter + vacant space added during the quarter). The ratio in Q4 2020 dropped by 3.4 points from Q3 and 13.2 points from Q4 2019 to 26.8%, indicating a weakening of turnover. The vacancy turnover rate fell below 30% for the first time since Q3 2015 (29.4%).

New Contract Rent

Figure 5 is the **new contract rent index**, which is the rent level for new lease contracts. The index for Q4 2020 was 121, down 11 points from Q3 and down 7 points from Q4 2019. New contract rent, which has continued to rise since Q2 2012, is showing signs of peaking out and may be starting to decline. There seems to be cases where lessors lower their asking rent in response to an increase in companies reducing their office size amid the spread of telework on the back of an uncertain economic outlook.

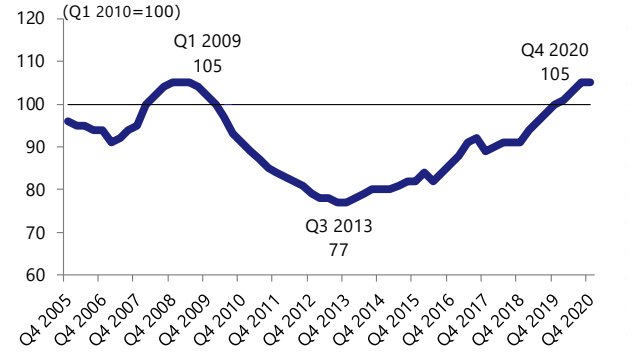
Figure 6 is the new contract rent index **by size of building**. The index for large buildings with a GFA of 5,000 tsubo or more was unchanged from Q3 at 120, while that for small & medium buildings with a GFA of less than 5,000 tsubo dropped by 12 points to 122. The rising trend of the index appears to be peaking out regardless of the size of building.

Figure 7: Contract Rent DI



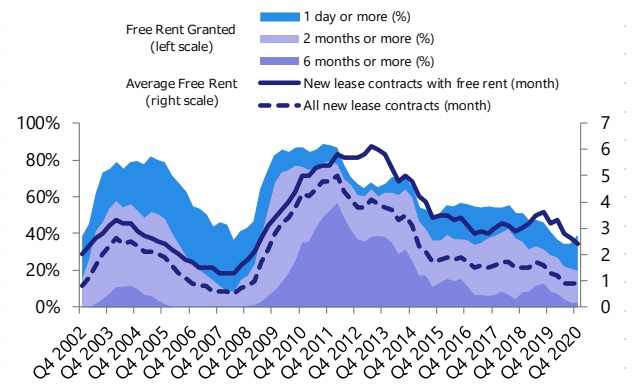
	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
Contract Rent DI	38	43	18	13	-22

Figure 8: Paying Rent Index



	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
Paying Rent Index	100	101	103	105	105

Figure 9: Free Rent



		Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
Ratio of Free Rent Granted	1 day +	40.8%	36.6%	34.3%	33.8%	38.2%
	2 mon. +	28.3%	26.8%	22.3%	20.9%	19.5%
	6 mon. +	8.7%	7.3%	3.9%	2.2%	2.4%
Average Free Rent Months	All	1.3	1.2	0.9	0.9	0.9
	w/ FR	3.2	3.3	2.8	2.6	2.4

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 Q4 2020 was -22, the first negative figure in 24 quarters. A negative DI means there were more buildings with lower new rent than those with higher new rent compared to six months ago. The DI fell 35 points from Q3. In Q4, the percentage of buildings with a rent decline more than doubled from Q3.

In Figure 11, we overlay the contract rent DI on the new contract rent index (Figure 5) and examine them later in the TOPIC 1 section.

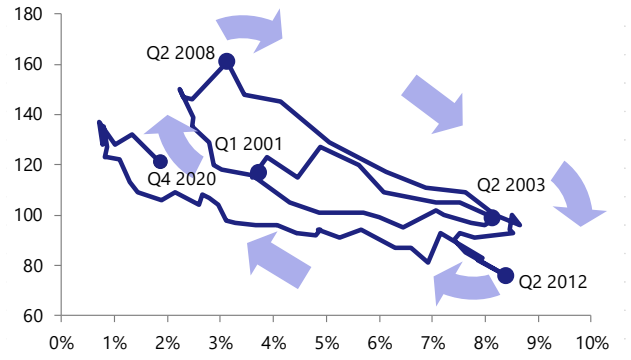
Paying Rent

Figure 8 shows the **paying rent index**, which includes both new lease rents and existing lease rents. The index in Q4 2020 was 105, unchanged from Q3 but up 5 points from Q4 2019. The upward trend since Q3 2013 has continued. As some companies have shown robust earnings during the pandemic, there does not seem to be a major impact on paying rent at present. However, future developments must be monitored carefully, since paying rent tend to change more slowly than new contract rent.

Free Rent

Figure 9 shows 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 Q4 2020, the ratio of offering free rent of one day or more was 38.2%, up 4.4 percentage points, and the ratio of offering free rent of six months or more was 2.4%, up 0.2 points. The average free rent months was 2.4 among lease contracts with free rent, 0.2months less than in Q3, and 0.9 months among all new contracts, unchanged from Q3.

Figure 10: Market Cycle



	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
Vacancy Rate	0.78%	0.71%	1.01%	1.34%	1.87%
New Contract Rent Index	128	137	128	132	121

Note: The vacancy rate before March 2011 is based on data by a major leasing agent.

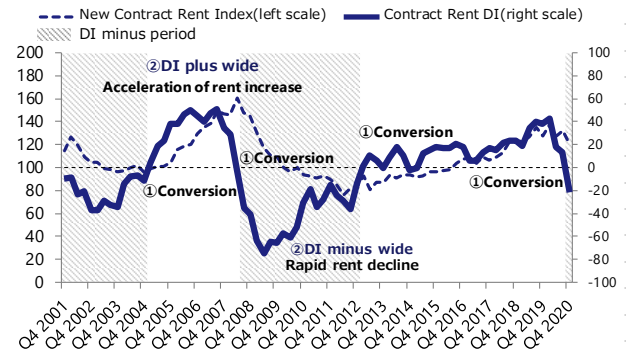
Market Cycle

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 cyclicality 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.

The office lease market had been in a recovery phase since 2013, however, the trend seems to have switched in Q1 2020, and the chart trended to the lower right in Q4 2020 as vacancy rates rose and the new contract rent index fell.

TOPIC 1

Figure 11: New Contract Rent Index and Contract Rent DI



	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
New Contract Rent Index	128	137	128	132	121
Contract Rent DI	38	43	18	13	-22

Figure 11 overlays the new contract rent index (Figure 5) on the contract rent DI (Figure 7). This has indicated the following trends thus far:

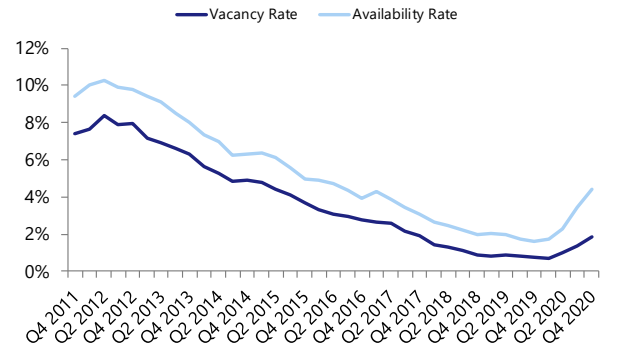
① The new contract rent index shifts its trend when the contract rent DI crosses the 0 line. In other words, when the DI value moves from positive to negative, the rent peaks out and turns downward. When the DI moves from negative to positive, the rent bottoms out and turns upward.

② When the absolute value of contract rent DI becomes large, the rise and fall of rent per tsubo accelerate.

The contract rent DI turned negative to -22 in Q4 2020 for the first time in 24 quarters (six years). We will keep an eye on the contract rent DI figures to see whether the negative trend will continue.

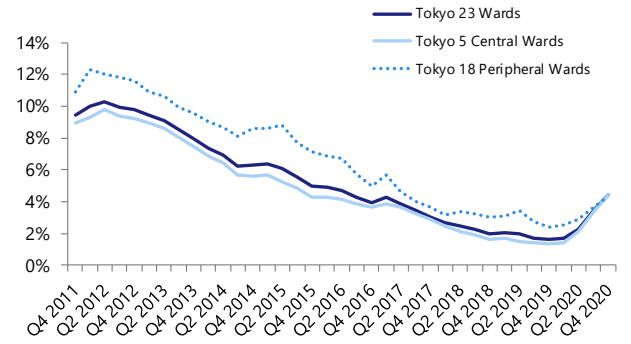
TOPIC 2

Figure 12: Availability Rate and Vacancy Rate



	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
Vacancy Rate	0.78%	0.71%	1.01%	1.34%	1.87%
Availability Rate	1.62%	1.71%	2.30%	3.42%	4.42%

Figure 13: Availability Rate (by Area)



	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
Tokyo 23 Wards	1.62%	1.71%	2.30%	3.42%	4.42%
Tokyo 5 Central Wards	1.36%	1.44%	2.13%	3.35%	4.43%
Tokyo 18 Peripheral Wards	2.44%	2.57%	2.86%	3.65%	4.38%

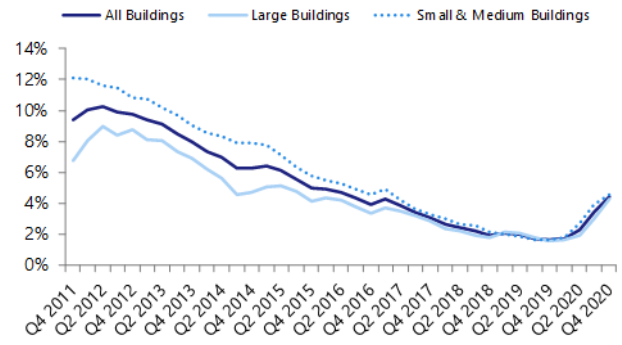
Vacancy Rate on an Availability Basis (Availability Rate)

Here we examine the availability rate, which we also examined in the TOPIC of Q3. This indicator is derived by dividing the vacant space from which the tenant has already vacated and is available for immediate occupancy (currently vacant) plus the space for which notice of cancellation has been given and is available (before the previous tenant has left) by the total rentable space.

Figure 12 shows the **availability rate** and **vacancy rate** of Tokyo 23 Wards since 2011. The availability rate was 4.42%, up 1.00 percentage points from Q3. The increase is larger than the 0.53-point rise of the vacancy rate. This suggests that finding the next tenant during the period between the notice of cancellation of the lease and the vacating of the previous tenant is becoming difficult.

Figure 13 shows the **availability rate** of Tokyo 23 Wards, the 5 Central Wards, and the 18 Peripheral Wards. The rate rose by 1.08 points from Q3 to 4.43% in the 5 Wards and by 0.73 points to 4.38% in the 18 Wards. When comparing the 5 Wards and the 18 Wards, the rate had been higher in the 18 Wards until Q3 but in Q4 2020 it was higher in the 5 Wards by 0.05 points. While the vacancy rate of the 5 Wards remained lower than that of the 18 Wards in Q4 2020 as shown in Figure 1 (vacancy rate (by area)), the vacancy rate might also become higher in the 5 Wards unless available space is promptly filled in the 5 Wards.

Figure 14: Availability Rate (by Building Size)



	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
All Buildings	1.62%	1.71%	2.30%	3.42%	4.42%
Large Buildings	1.61%	1.63%	1.96%	3.00%	4.31%
Small & Medium Buildings	1.62%	1.80%	2.68%	3.90%	4.54%

Figure 14 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, with the availability rate rising regardless of the size or area of the building. We will continue to monitor the rate and other indicators closely to see whether this trend will continue.

Review of the calculation method of vacancy turnover rate

We have reviewed our calculation method of the vacancy turnover rate and recalculated past and present data. Please note that the new method has been reflected from this report (Q4 2020) and that figures in the past reports issued already will not be updated.

The past data that were recalculated are posted on our website. Those of you who are referring to the chronological trend of the vacancy turnover rate (Figure 4) are requested to replace the data.

Reference

Figure 15: Major Building Completions (Q4 2020)

Name	Floors Above ground/ Below ground	Ward	Address	Completion	Total floor area (tsubo)
SMBC TOYOSU BILUDING	24/1	Koto	2-2-1 Toyosu	Oct 2020	21,958
SHIODOME WING	14/1	Minato	1-2-15 Higashisinbashi	Nov 2020	2,981
Prime Terrace KAMIYACHO	10/1	Minato	4-1-13 Toranomon	Nov 2020	2,805

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

Figure 16: Major Office Relocations (Q4 2020)

Company	From	To	Timing	Purpose	Size (tsubo)
Hitachi Social Information Services, Ltd.	Yokohama Mitsui Building *Yokohama City*	Omori Bellport D *Shinagawa Ward*	Jan 2021	Greater efficiency	1,440
H.S. Insurance Co., Ltd.	Luogo Shiodome *Minato Ward*	CROSS DOCK HARUMI *Chuo Ward*	Feb 2021	Greater efficiency	305
KYODO PUBLIC RELATIONS CO., LTD.	DOWA BUILDING *Chuo Ward*	Ginza Shochiku Square *Chuo Ward*	June 2021	Greater efficiency	473
GREE, Inc.	Roppongi Hills Mori Tower *Minato Ward*	Roppongi Hills Gate Tower *Minato Ward*	Aug 2022	Other	2,940

Source: Compiled by Xymax Real Estate Institute based on information released by companies.
The sizes of offices are estimates.

Survey Overview

	Vacancy 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	8,610 buildings	7,989contracts	7,989 contracts	460 contracts
How to Calculate	• 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. ・Availability rate ＝available space ÷ rentable space ・Available space Total available space, which consist of vacant space and space for which notice of cancellation has been given. 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.	• Increase in volume of vacant space a. Space in existing buildings formerly occupied by tenants b. Total rentable area of new completions • 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 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.	• 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"	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). This model shows changes in new contract rents after removing property-specific variables.

	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	384 contracts	4,000 contracts	72 contracts
How to Calculate	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).	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). With this method, influences from replacement of sample data and deterioration of buildings over age are removed from the result.	• 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. 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.

Appendix: Xymax REI Research Updates (Nov. 2020 – Jan. 2021)

Greater Tokyo Office Worker Survey **November 24, 2020**

- This report is a summary of the results of a questionnaire survey of office workers in Greater Tokyo on the latest trend of the actual work styles and values of workers in Greater Tokyo.

Building Owner Survey 2020 (Main Report) **November 26, 2020**

- This report is a summary of the results of a questionnaire survey of owners of small & medium-sized buildings nationwide who lease out their buildings on the management state of the building lease business, its outlook, and responses to changes in the environment surrounding the buildings.

Metropolitan Areas Office Demand Survey Autumn 2020 **December 2, 2020**

- This report releases the results of a questionnaire survey of companies on their office use and the work styles of their employees.

Fact-Finding Study on Store Strategies during the COVID-19 Pandemic **December 18, 2020**

- This report summarizes the details of commercial operators' store strategies as well as their changes and future direction, based on a questionnaire survey of operators.

Real Trends of Real Estate 2021 **December 25, 2020**

- This report focuses on themes that are deemed important in the society that surrounds us and examines the situation of the themes as well as their impact on real estate.

Supply of New Office Space 2021 **January 15, 2021**

- This report is a summary of the results of an annual aggregation of rentable office space, targeting buildings with a GFA of 3,000 tsubo or more used mainly as offices and are to be completed in Tokyo 23 Wards and Osaka City.

Office Stock Pyramid 2021 **January 15, 2021**

- In this report we aggregate rentable office space and number of buildings by size, targeting buildings with a GFA of 300 tsubo or more used mainly for offices in Tokyo 23 Wards and Osaka City.

Greater Tokyo Company Survey on Work Styles and the Workplace | December 2020 **January 27, 2021**

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

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