

Office Market Report

Tokyo | Q2 2022

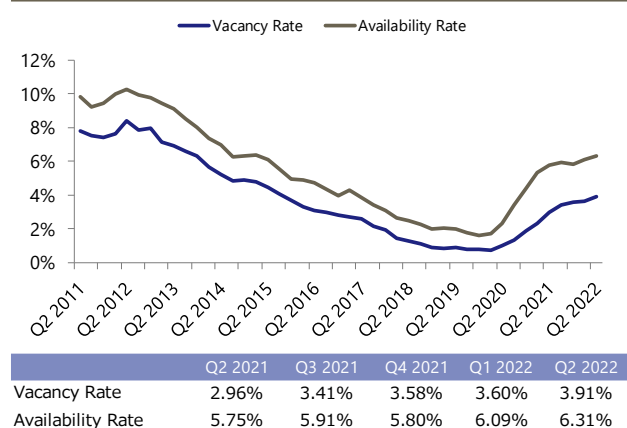
July 27, 2022



Summary

- In Q2 (April–June) 2022, the office market of the 23 wards of Tokyo (“Tokyo 23 Wards”) showed the same trend as the previous quarter: vacancy rates rose mildly and rent levels dropped marginally.
- The **vacancy rate** was 3.91%, up 0.31 pt from Q1 2022. The **availability rate**, which includes space for which a cancellation notice has been given and vacant space currently available (i.e., accepting tenant applications), was 6.31%, up 0.22 pt from Q1 2022. The **increase and decrease in vacant space** showed that the increase outweighed the decrease for the ninth consecutive quarter, as vacant space increased by 175,000 tsubo (1 tsubo = approx. 3.3 sqm) and decreased by 144,000 tsubo. The **vacancy turnover ratio**, which is the ratio of vacant spaces leased to tenants, dropped 1.9 pt to 24.8%, the first time it declined to below 25% in 10 years since Q2 2021.
- The **new contract rent index**, i.e., the level of new lease rent, was 85, down 1 pt from Q1 2022. The **contract rent diffusion index**, the percentage of buildings with a rise in new rent minus that of buildings with a drop in new rent, was -3, a negative value for the seventh consecutive quarter although it rose 23 pt from Q1 2022.
- The **paying rent index**, which includes both new and existing rents, was unchanged at 100.
- The **average number of free rent months** among all new lease contracts was 3.7 months, the **ratio of free rent offered for more than two months** was 56.1%, and 18.3% for more than six months.

Figure 1: Vacancy Rate & Availability Rate



Vacancy

Figure 1 shows the **vacancy rate** and the **availability rate**.^{*1, 2} The vacancy rate of Tokyo 23 Wards in Q2 2022 rose 0.31 pt from Q1 2022 to 3.91%, and the availability rate rose 0.22 pt to 6.31%. Although we are beginning to see office expansions, both rates have risen on the back of an increase in cancellations.

*1 Availability rate: The sum of currently vacant space, space for which a cancellation notice has been given and space that is accepting tenant applications (before the previous tenant has left) divided by rentable space

*2 For the rates by size of building and area, see *Vacant Office Space Monthly Report Tokyo | June 2022*.

<https://www.xymax.co.jp/english/research/images/pdf/20220705.pdf>

Figure 2: Increase and Decrease in Vacancies (23 Wards, All Sizes)

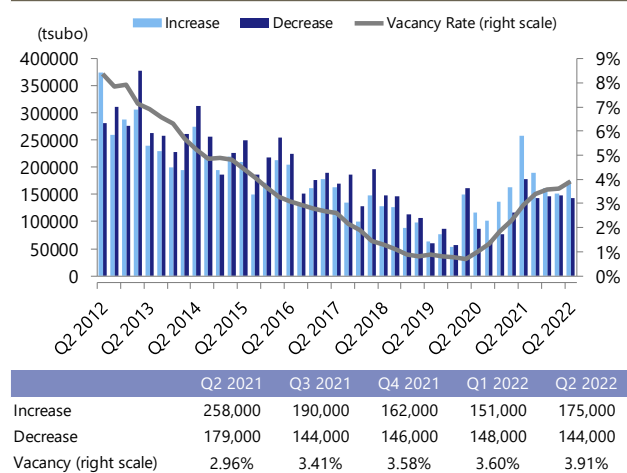


Figure 2 is the **increase and decrease in vacant space**. In Q2 2022, the increase in vacant space was 175,000 tsubo, while the decrease was 144,000 tsubo. The increase exceeded the decrease for the ninth consecutive quarter. Although there have been rises in the need for office expansion to accommodate increased workforce and in the need for relocating to a building with better specifications than the current building or to a building with environmental certification such as ZEB, vacant space has been increasing at a faster pace.

Figure 3: Vacancy Turnover Ratio (4-quarter moving average)

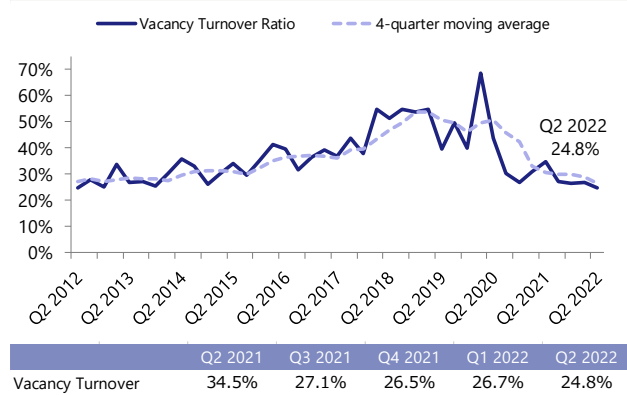


Figure 3 shows the **vacancy turnover ratio**, the ratio of vacant spaces leased to tenants during the quarter to the total vacant office stock (vacant office stock at start of quarter + vacant space added during the quarter). The ratio in Q2 2022 declined to below 25% for the first time in 10 years since Q2 2012 to 24.8%. Although there has been some vacancy turnover since last year following relocations, the turnover rate has remained low due to a build-up of vacant stock as the increase of vacant space outpaced the decrease.

Figure 4: New Contract Rent Index



Figure 5: New Contract Rent Index (by Size)

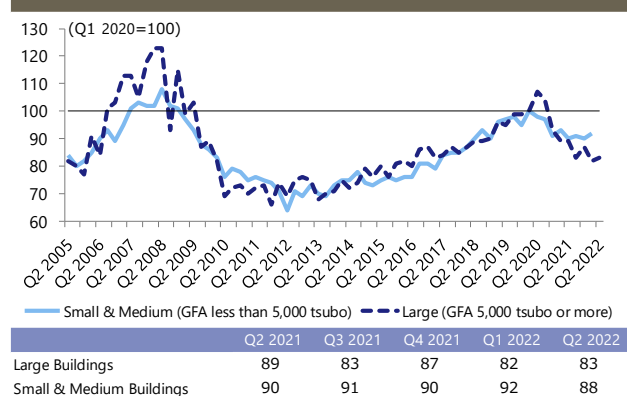
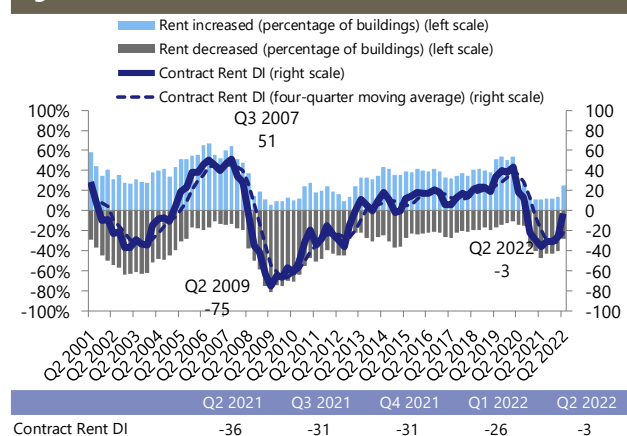


Figure 6: Contract Rent DI



New Contract Rent

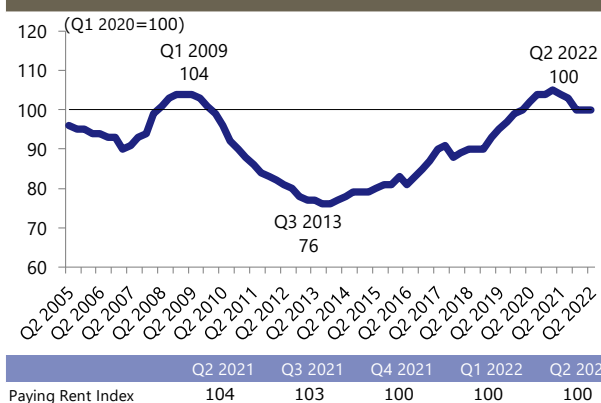
Figure 4 is the **new contract rent index**, which indicates the rent level for new lease contracts. The index for Q2 2022 was 85, down 1 pt from Q1 2022 and down 4 pt from Q2 2021. Some lessors appear to be accepting a decrease in rent in contract negotiations on the back of the rise in vacancy rates. We must keep a close eye on the development of rent, since the contract rent DI (see Figure 6), a leading indicator of the new contract rent index,³ has risen 23 pt from Q1 2022.

*3 For the relationship between the new contract rent index and the contract rent DI, see "TOPIC 1" of *Office Market Report / Tokyo Q4 2020*.
<https://www.xymax.co.jp/english/research/images/pdf/20210203.pdf>

Figure 5 is the new contract rent index **by size of building**. The index for large companies with a gross floor area (GFA) of 5,000 tsubo or more was up 1 pt from Q1 2022 at 83, while that for small & medium buildings with a GFA of 300–4,999 tsubo was down 4 pt at 88.

Figure 6 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 change in new contract rent. Although the DI in Q2 2022 was -3, in negative territory for the seventh consecutive quarter, it rose as much as 23 pt from Q1 2022. A negative DI means there were more buildings with lower new rent than those with higher new rent compared to six months ago.

Figure 7: Paying Rent Index



Paying Rent

Figure 7 shows the **paying rent index**, which includes both new lease rents and existing lease rents. The index lags new contract rent. The index in Q2 2022 was unchanged from Q1 2022 at 100 amid a decline in new lease rent.

Free Rent

Figure 8 shows the percentage of new lease contracts with free rent (FR) to all new lease contracts (**ratio of FR offered**) and the average free rent period (**average FR months**). In Q2 2022, the ratio of offering FR for two months or more was 56.1%, representing a rise from Q1 2022, while that for six months or more was 18.3%. The average number of FR months among lease contracts with FR was 3.7, increasing consecutively since Q1 2021. Amid an increasing prevalence of offering FR for two to three months, a rising number of contracts offer FR for six months or more, suggesting that offering FR has become a common practice in the office market.

Figure 8: Free Rent

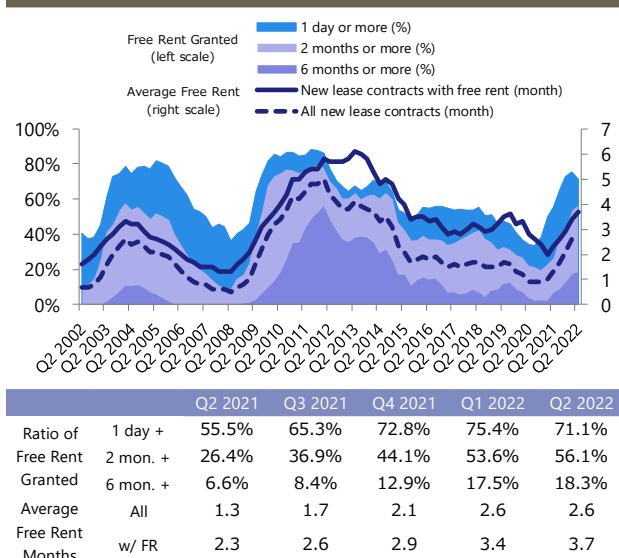
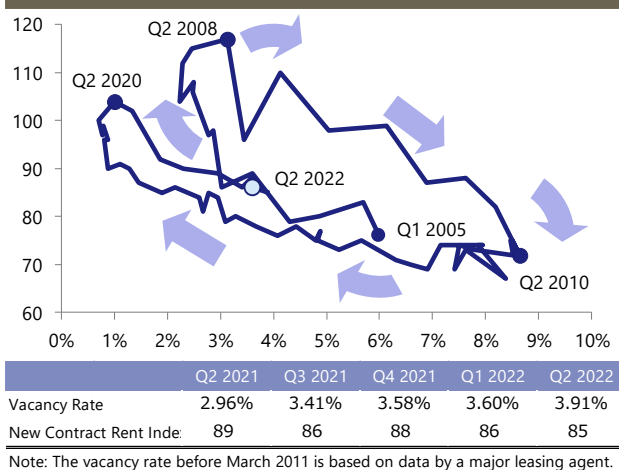


Figure 9: Market Cycle



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

Figure 9 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 cyclicity of the market, with the chart trending to the upper left (vacancy down, rent up) from 2005, moving to the lower right (vacancy up, rent down) in 2008 and returning to the upper left (vacancy down, rent up) in 2010.

The trend of the office lease market, which had been in a recovery phase since 2013, seems to have reversed in Q2 2020. The chart trended to the lower right in Q2 2022, as the vacancy rate rose, and new contract rent index dropped.

Reference

Figure 10: Major Building Completions (Q2 2022)

Name	Floors Above ground/ Below ground	Ward	Address	Completion	Total floor area (tsubo)
Kanden Real Estate Yaesu Bldg	13/1	Chuo	1-11-2 Kyobashi	May 2022	4,078
Ueno 6-chome MM Bldg	11/1	Taito	6-1-14 Ueno	May 2022	2,269
Sumitomo Fudosan Ueno Okachimachi Bldg	12	Taito	3-7-4 Motoasakusa	June 2022	1,928

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

Figure 11: Major Office Relocations (Q2 2022)

Company	From	To	Timing	Purpose	Size (tsubo)
KYOCERA Corporation	I.S Bldg and other office branches in Metropolitan Areas <i>Shinagawa Ward</i>	Tokyo Mita Redevelopment Project Office Tower <i>Minato Ward</i>	2023	business efficiency	5,600
ORIENTAL GIKEN INC.	Confort Yasuda Bldg <i>Chiyoda Ward</i>	Keihan Otemachi Building <i>Chiyoda Ward</i>	May 2022	business expansion	954

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	8,723 buildings	12,027 contracts	12,027 contracts	750 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. • 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. <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 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 <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" 	<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) Calculate the rent estimated in the preceding step based on Q1 2020 as the base point (=100) by market segment (four segments).</p> <p>4) Integrate the figure of the preceding step as a Fisher index using gross floor area as weight. The New Contract Rent Index of the Tokyo office market is the integrated figure.</p> <p>This model shows changes in new contractrents after removing property-specificvariables.</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	342 contracts	4,429 contracts	48contracts
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: "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"> • Free Rent Period (Until Q4 2020) The period between the start of the contract and the start of the rent, shown in number of days. (Q1 2021 onward) The period for new contracts (excl. contracts for expansion within building and recontracts) during which rent has continuously been reduced to an amount equivalent or close to CAM charges since the date of contract. • 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 period. • Average Free Rent (Month) of Contracts with Free Rent The simple average of the free rent period of lease contracts with a free rent period

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