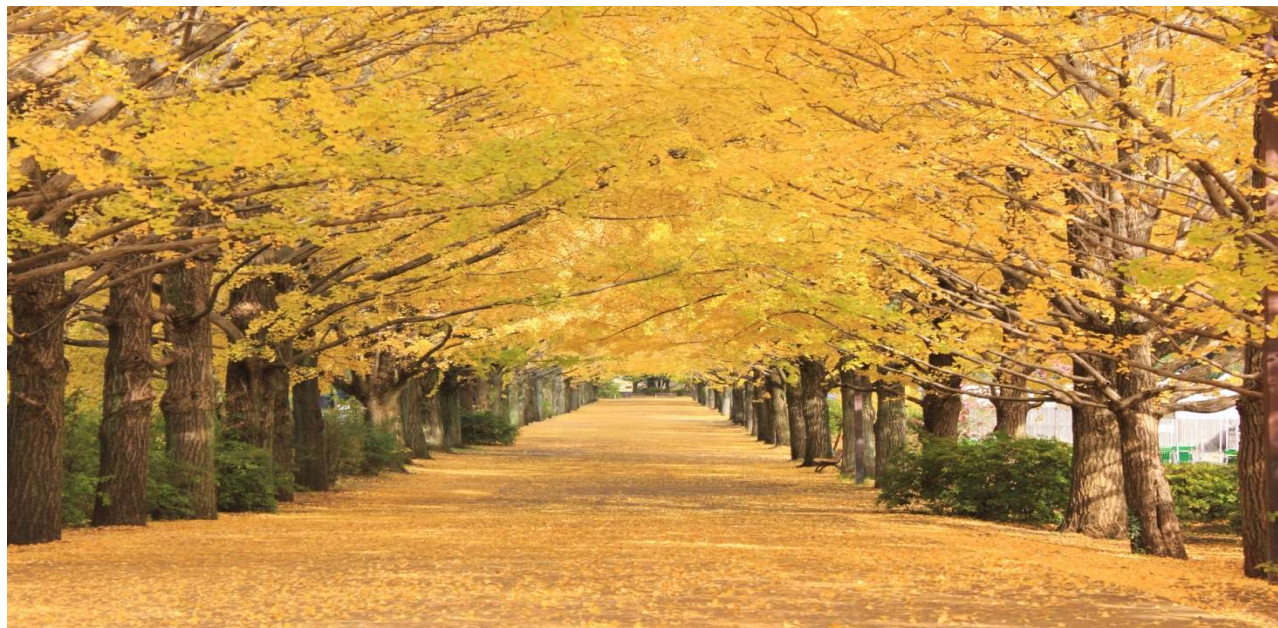


Office Market Report

Tokyo | Q3 2022

October 26, 2022



Summary

- In Q3 (July–September) 2022, the office market of the 23 wards of Tokyo (“Tokyo 23 Wards”) showed a marginal increase in rent levels amid a mild rise in the vacancy rate.
- The **vacancy rate** was 4.02%, up 0.11 pt from Q2 2022. The vacancy rate reached 4% for the first time in seven years since Q3 2015. The **availability rate**, which includes space for which a cancellation notice has been given and vacant space current available (i.e., accepting tenant applications), was 6.11%, down 0.2 pt from Q2 2022. The **increase and decrease in vacant space** showed that the increase outweighed the decrease for the tenth consecutive quarter, as vacant space increased by 192,000 tsubo (1 tsubo = approx. 3.3 sqm) and decreased by 178,000 tsubo. The **vacancy turnover ratio**, which is the ratio of vacant spaces leased to tenants, rose 3.4 pt from Q2 2022 to 28.2%.
- The **new contract rent index**, i.e., the level of new lease rent, was 91, up 6 pt from Q2 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, dropped 2 pt from Q2 2022 to -21, a negative value for the eight consecutive quarter.
- The **paying rent index**, which includes both new and existing rents, rose 2 pt from Q2 2022 to 102.
- The **average number of free rent months among lease contracts with free rent** was 3.8 months, the **ratio of free rent of more than two months** was 50.6%, and that of **more than six months** was 20.7%.

FIGURE 1: VACANCY RATE & AVAILABILITY RATE

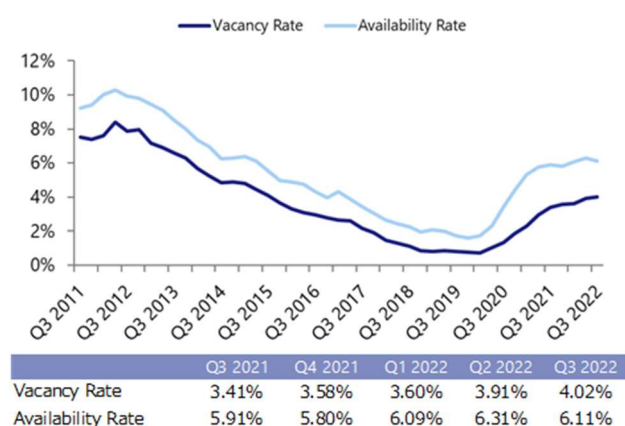


FIGURE 2: INCREASE AND DECREASE IN VACANCIES (23 WARDS, ALL SIZES)

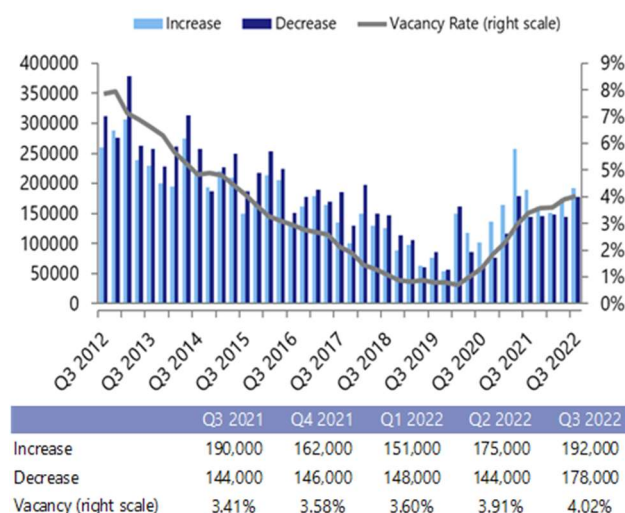
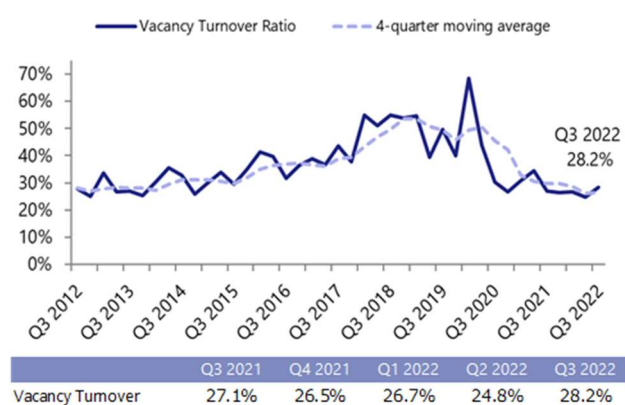


FIGURE 3: VACANCY TURNOVER RATIO (4-QUARTER MOVING AVERAGE)



Vacancy

Figure 1 shows the **vacancy rate** and the **availability rate**.^{*1*2} The vacancy rate of Tokyo 23 Wards in Q3 2022 rose 0.11 pt from Q2 2022 to 4.02%. It is the first time in seven years, since Q3 2015, for the vacancy rate to rise above 4%. The availability rate dropped 0.2 pt from Q2 2022 to 6.11%. The background to the rise in vacancy rate and a drop in availability rate includes companies' robust office demand, which has resulted in vacancies being filled between the cancellation notice date and the date when the tenant leaves amid a continued rise in cancellations, and the strong intention of lessors to seek early contract to avoid manifestation of or prolonged vacancies.

*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 | September 2022*.
<https://www.xymax.co.jp/english/research/images/pdf/20221005.pdf>

Figure 2 is the **increase and decrease in vacant space**. In Q3 2022, the increase in vacant space was 192,000 tsubo, while the decrease was 178,000 tsubo. The increase exceeded the decrease for the tenth consecutive quarter. The amount of both the increase and decrease in vacant space has increased from Q2 2022, indicating active relocation by tenants.

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). Although low at 28.2%, the ratio in Q3 2022 rose slightly from Q2, suggesting that vacancy turnover is starting to improve.

FIGURE 4: NEW CONTRACT RENT INDEX


New Contract Rent

Figure 4 is the **new contract rent index**, which indicates the rent level for new lease contracts. The index for Q3 2022 was 91, up 6 pt from Q2 2022 and up 5 pt from Q3 2021. Since the vacancy rate has risen from Q2 and the contract rent DI (see Figure 6), the leading indicator of the new contract rent index, remains in the negative, it is difficult to determine whether new rent has bottomed, warranting close examination of the development of rent going forward.

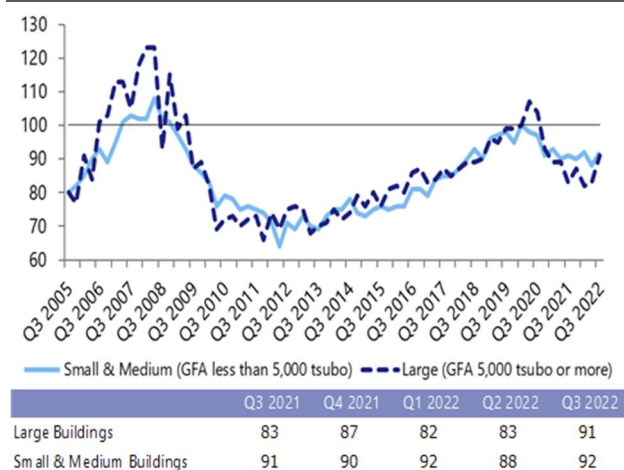
FIGURE 5: NEW CONTRACT RENT INDEX (BY SIZE)


Figure 5 is the new contract rent index **by size of building**. The index for large buildings with a gross floor area (GFA) of 5,000 tsubo or more was up 8 pt from Q2 2022 at 91, while that for small & medium buildings with a GFA of 300–4,999 tsubo was up 4 pt at 92. Demand for relatively new, large buildings in good locations remains strong, hence the strength in rent.

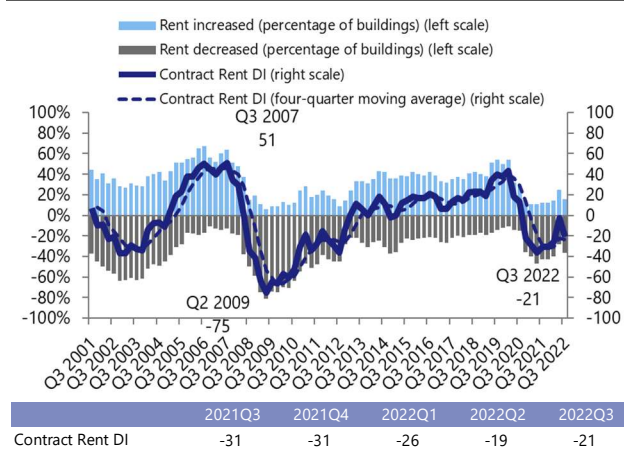
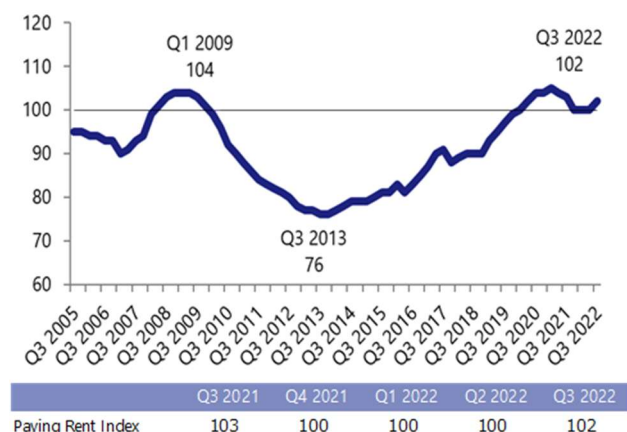
FIGURE 6: CONTRACT RENT DI


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. In Q3 2022, the DI was -21, down 2 pt from Q2 2022^{*3} and in negative territory for the eighth consecutive quarter. A negative DI means there are more buildings with lower new rent than those with higher new rent compared to six months ago. Hoping to avoid prolonged vacancies, some building owners presented more accommodating conditions.

^{*3} The contract rent DI was -3 in *Office Market Report Tokyo* | Q2 2022. However, it has been revised to -19 due to a recalculation using contract data aggregated after the release of the report.

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 and has less volatility. In Q3 2022, the index was 102, up 2 pt from Q2, when the index remained unchanged.

Free Rent

Figure 8 shows the percentage of new lease contracts with free rent (FR) to all new lease contracts (**ratio of FR granted**) and the average free rent period (**average FR months**). In Q3 2022, the ratio of granting FR of 1 day or more was 65.5% and that of two months or more was 50.6%, down 5.6 pt and 5.5 pt from Q2, respectively. On the other hand, the ratio of granting FR of six months or more rose 2.4 pt to 20.7%. The average number of FR months among lease contracts with FR was 3.8, increasing consecutively since Q1 2021. While the ratio of granting FR of less than six months dropped from Q2 2022, the ratio of granting FR of six months or more rose. Some of the owners of buildings that have had vacancies for a long time sought to attract tenants by granting free rent for an extended amount of time.

FIGURE 8: FREE RENT

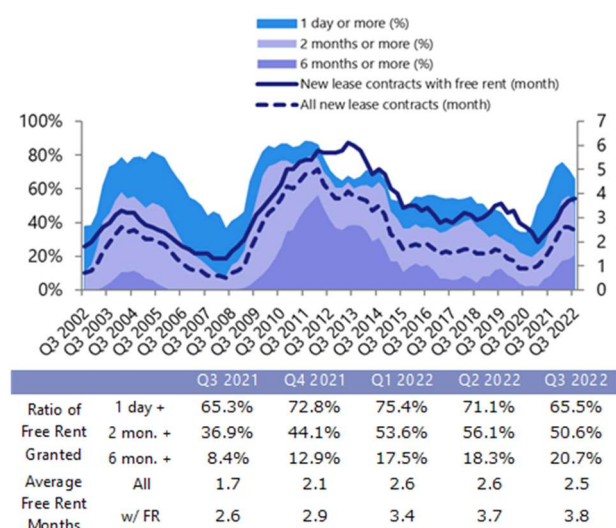
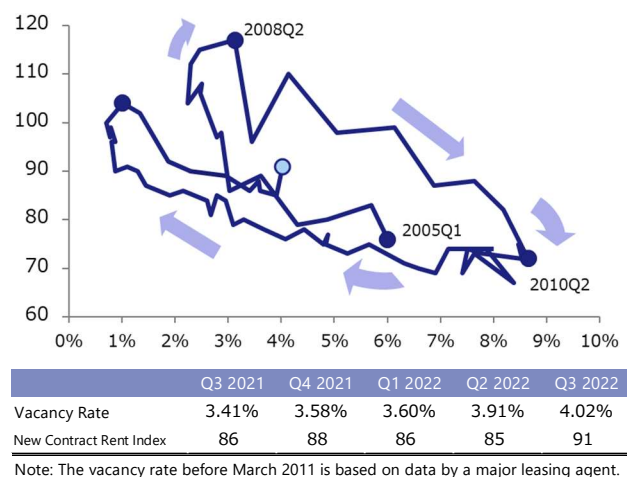


FIGURE 9: MARKET CYCLE



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

Market Cycle

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) in 2005, moving to the lower right (vacancy up, rent down) in 2008, and returning to the upper left (vacancy down, rent up) in 2010.

In Q3 2022, the chart moved to the upper right since both the vacancy rate and new contract rent index rose. However, this appears to be a move amid the declining phase of the rental market, which has continued since Q2 2020.

Reference

FIGURE 10: MAJOR BUILDING COMPLETIONS (Q3 2022)

Name	Floors Above ground/ Below ground	Ward	Address	Completion	Total floor area (tsubo)
KUDAN-KAIKAN TERRACE	17/3	Chiyoda	1-6-5 Kudanminami	Jul 2022	20,581
OAK KONAN SHINAGAWA	12/1	Minato	2-10-4 Konan	Jul 2022	4,940
TOKYO MIDTOWN YAESU YAESU CENTRAL TOWER	45/4	Chuo	2-2 Yaesu	Aug 2022	85,880

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

FIGURE 11: MAJOR OFFICE RELOCATIONS (Q3 2022)

Company	From	To	Timing	Purpose	Size (tsubo)
UCC HOLDINGS CO.,LTD.	Daiwa Onarimon Bldg <i>Minato Ward</i>	Sumitomo Fudosan Aoyama West Bldg <i>Minato Ward</i>	Feb 2023	Lease Termination	1,100
SAFIE, INC.	A-PLACE Gotanda Ekimae Bldg Nikko Gotanda Bldg <i>Shinagawa Ward</i>	Sumitomo Fudosan Osaki Garden Tower <i>Shinagawa Ward</i>	Jul 2023	Branch Office Consolidation	1,100

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

Survey Overview				
	Vacancy Rate and 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	8,749 buildings	12,320 contracts	12,320 contracts	471 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 <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) Calculate the rent estimated in the preceding step based on Q1 2020 as the base point (=100) by market segment (four segments). 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.

Survey Overview			
	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	569 contracts	4,451 contracts	41 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 (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

For further inquiries please contact below:

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