

OFFICE MARKET REPORT

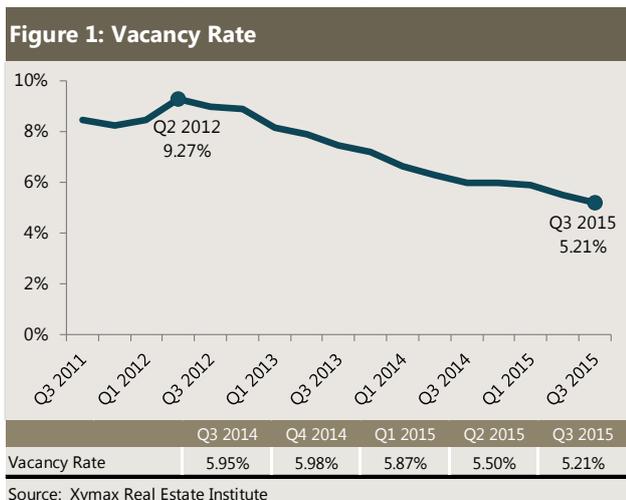
TOKYO | Q3 2015

November 4, 2015



Summary

- Overall office market is having modest growth of both new rents and paying rents in the tight market as companies' forward-looking relocation demand, such as expanding business or hiring more workers, increased.
- Vacancy rates decreased by 0.29 points quarter-on-quarter to 5.21%, marking 13 straight quarters of decreases. Demand is spreading to periphery markets as annual new supply remains equivalent to that of typical years and available space is becoming limited in some high-demand office areas.
- New Contract Rent Index (level of new rents) was 96, a quarter-on-quarter increase of 3 points. Contract Rent DI (the percentage of buildings with rent increase minus that of buildings with rent decrease) was +15; fewer buildings had a rent decrease.
- Paying Rent Index (level of new rents and existing rents) was 82, a quarter-on-quarter increase of 1 point.
- Average Free Rent Month was 2.2 months, a quarter-on-quarter decrease of 0.6 month. Six months of free rent were given in 16.5% of all the contracts, a decrease of 8.5 points.



Vacancy

Figure 1 shows changes in vacancy rates in Tokyo 23 Wards since 2011. The vacancy rates in the third quarter of 2015 decreased for the 13th consecutive quarter by 0.29 points to 5.21% from 5.50% in the previous quarter.

Company's office strategies became more positive as they plan to expand their business; a shift from cost-conscious strategies started in 2009, which lasted until around 2012. IT companies and staffing companies are among the tenants who relocated or expanded office for the purpose of expanding business opportunities, hiring talented job candidates or improving work environment.

The Shibuya Station area, a place appealing to job candidates, is high in demand in particular and having limited availability of office stock. Demand is, therefore, spreading to periphery markets like Shinjuku and Ebisu with relatively convenient transportation.

In the areas around Yamanote line and subway stations, where convenient transportations are available, leasing activities have been successful; vacant offices in small and medium buildings are also being leased up.

By contrast, the situation of office buildings that are not suitable for forward-looking relocations remains tough. Landlords have to make concessions to attract potential tenants. This is because tenants are no longer likely to put priority on cost-cutting and downgrade the building or the location.

As described, the expanding relocation demand combined with the typical annual volume of new supply in 2015 of 183,000 tsubo (193,000 tsubo on average in the period between 2003-2014)*, are the factors of the decrease in vacancy and the tight supply-demand balance in the office space market.

* Xymax Real Estate Institute "Supply of New Office Space Survey 2015" released on February 2, 2015

1 tsubo = approx. 3.3 sqm

Figure 2: New Contract Rent Index



Source: Xymax Real Estate Institute

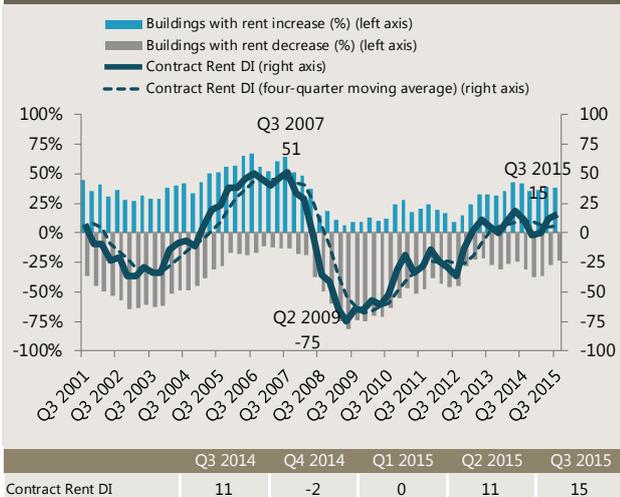
Figure 3: New Contract Rent Index by Size of Building



Source: Xymax Real Estate Institute

1 tsubo = approx. 3.3 sqm

Figure 4: Contract Rent DI (Tokyo 23 Wards)



Source: Xymax Real Estate Institute

New Contract Rent

Figure 2 shows changes in New Contract Rent Index, an index of rent agreed for a new lease. The third quarter of 2015 was 96, which is 3 points higher than 93 in the previous quarter. While available space is becoming limited, the overall market is seeing a modest increase of contract rents.

Figure 3 shows changes in New Contract Rent Index by size of building. Small and medium office buildings (up to GFA 5,000 tsubo) and large office buildings (over GFA 5,000 tsubo) both had a quarter-on-quarter increase to 97 and 101, respectively.

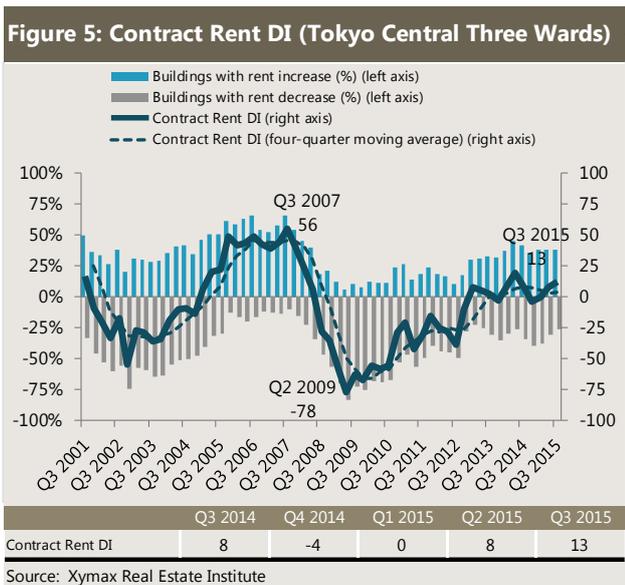
New rents moved up mainly in large buildings in and around high-demand areas that meet the demand of companies with forward-looking relocation plan.

Rapid growth is, however, observed only in some high-demand areas like Shibuya where demand is strong and supply is short. Many office landlords in other areas continue to focus on improving occupancy to recover the sluggish income they had in 2011-2013 and remain cautious on drastic rent increase.

Office buildings that are less likely to be chosen by tenants with forward-looking relocation plan, such as those in less convenient areas, constructed under the old seismic standards or with low-grade features are still having difficulties in raising rents.

Growth of new rents is gradual because there are no particular outstanding business sectors which can afford high rents and push the rental growth, such as foreign financial institutions in the fund bubble period in 2006-2008.

Figures 4 and 5 are changes in Contract Rent Diffusion Index (DI). The third quarter of 2015 was +15 for Tokyo 23 Wards and +13 for Central Three Wards, both indicated that there were more buildings with rent increase than buildings with rent decrease. They were both higher than the previous quarter of +11 for Tokyo 23 Wards and +8 for Central Three Wards.

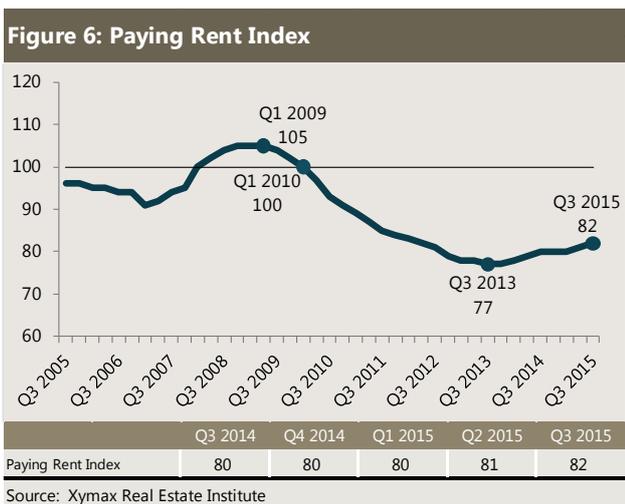


A breakdown of DI indicates that approx. 38% of the buildings in Tokyo 23 Wards achieved a rent increase (q-o-q change 0%) while approx. 23% of the buildings had a rent decrease (q-o-q change -4%).

As a background of this, more offices are being leased up without further rent reduction than before as demand is gradually spreading to periphery areas with relatively good transportation access following the shortage of availability in high-demand areas.

Paying Rent

Paying Rent Index, of which new contract rents and existing rents are both surveyed, show changes in rents paid for office space by companies, the income generated from office buildings. Figure 6 shows changes since 2005.

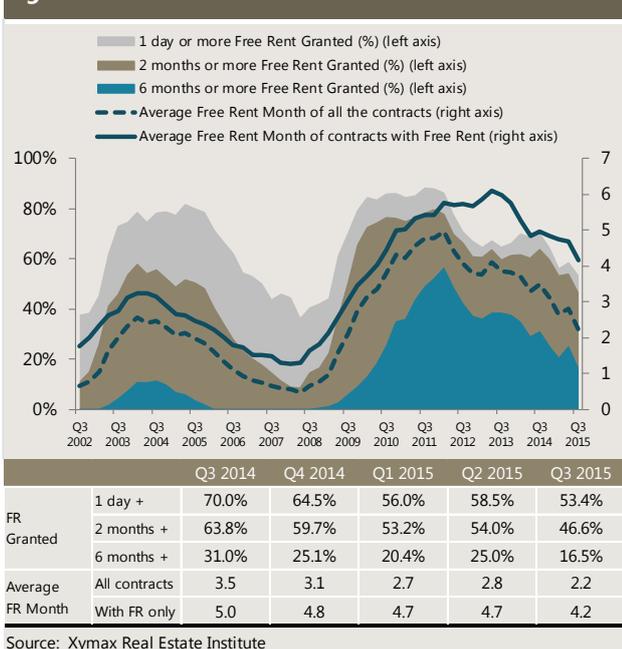


Paying Rent Index was 82 in the third quarter of 2015, a quarter-on-quarter increase of 1 point and year-on-year increase of 2 points (based on Q1 2010=100). Paying Rent Index is on a rise, albeit very modest, after bottoming in the third quarter of 2013.

This is because, thanks to the growth of the new contract rents started in 2012, the rent level now rarely decreases on tenant change.

Another factor is the limited availability. The vacancy rates continued to mark a record low since 2011. It is becoming more difficult for companies to find office with convenience and grade equivalent to their current place without increasing the rent. Recent lease renewals do not always result in rent reduction but sometimes achieve rent increase if the location and grade of the building are good.

Figure 7: Free Rent



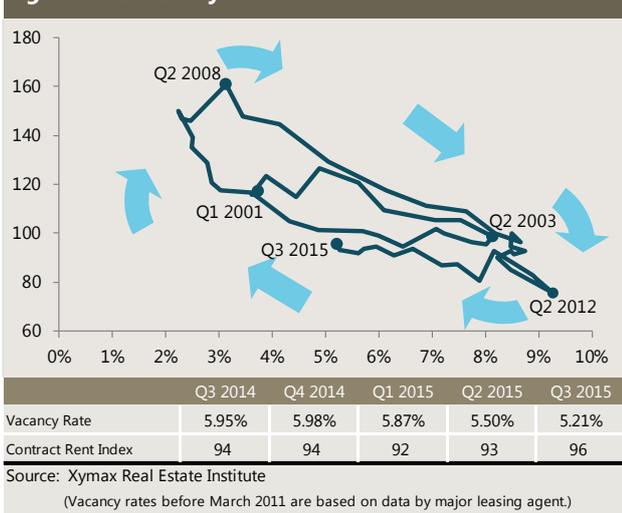
Free Rent

Figure 7 shows changes in the free rents given to all the new contracts (Ratio of Free Rent Granted) and changes in the average free rent period (Average Free Rent Month). The ratio for all the groups had a drastic fall in the third quarter of 2015. Similarly, the average period for both groups (all the contracts and contracts with free rent) also decreased.

The ratio of contracts with one day or more free rent was the lowest since 2011 but still remained around 50%, indicating that free rent is becoming a typical practice in Tokyo's office space market.

The ratio of contracts with six months or more free rent was 16.2%, a decrease by roughly 40 points from the record high of 56.3% posted in the second quarter of 2012. As the office space market recovered, the major purpose of free rent has changed from the long-period free rent as an incentive to attract tenants to the short-period free rent so that tenants do not have to pay double rents when relocating.

Figure 8: Market Cycle



Market Cycle

Figure 8 is a graph plotted by quarter based on vacancy rates on the horizontal axis and New Contract Rent Index on the vertical axis.

The graph shows that the market is cyclical: the plot started to move to lower right in 2001 (vacancy up, rent down) and remained static in 2003-2004, then it started to move to upper left in 2005 (vacancy down, rent up) and to lower right again in 2008 (vacancy up, rent down).

Trends in 2015 show that the Tokyo's office space market is finally out of the slowdown started in 2010 and moving toward recovery with a modest decrease in vacancy and modest increase in new rents.

Reference

Figure 9: Major Building Completions (Q3 2015)

Name	Floors	Ward	Address	Completion	GFA
S-GATE Akasaka	8	Minato	6-2-4 Akasaka	Jul 2015	1,002 tsubo
77Bank Ginza Building	11 + B1	Chuo	4-14-11 Ginza	Aug 2015	943 tsubo
Shibuya 363 Shimizu Building	11	Shibuya	3-6-3 Shibuya	Aug 2015	904 tsubo

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

Figure 10: Major Office Relocations (Q3 2015)

Company	From	To	Month Year	Purpose	Size
Hitachi Metals	Seavans N Building, etc. <i>Minato and Taito Wards</i>	Shinagawa Season Terrace <i>Minato Ward</i>	Dec 2015	Consolidation	3,000 tsubo
BOT Lease	Nihonbashi Honcho 1-Chome Building <i>Chuo Ward</i>	Tokyo Nihonbashi Tower <i>Chuo Ward</i>	Nov 2015	Consolidation	1,300 tsubo
NJS	Company Building <i>Shinjuku Ward</i>	Hamamatsucho Building <i>Minato Ward</i>	Sep 2015	Consolidation	1,000 tsubo
LINE and affiliates	Shibuya Hikarie <i>Shibuya Ward</i>	Shinjuku Miraina Tower <i>Shinjuku Ward</i>	Jan 2017	Expansion & Consolidation	5,670 tsubo
Epson	Shinjuku NS Building, etc. <i>Shinjuku and Chiyoda Wards</i>	(JR Shinjuku Station Shin- minamiguchi Building) <i>Shinjuku Ward</i>	Mar 2016	Consolidation	2,520 tsubo

Source: Compiled by Xymax Real Estate Institute based on information released by companies.
The size of the office space is an estimate.

1 tsubo = approx. 3.3 sqm

Overview of Our Researches					
	Vacancy Rate	New Contract Rent Index	Contract Rent DI	Paying Rent Index	Free Rent Granted (%) & Average Month
Description	Vacant space versus total 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.	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).	Free rent distribution and average period. Free rent is the time lag between the start of the contract and the start of the rent payment.
Main Point	Supply and demand balance in the market	Level of contract rents	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	Tokyo 23 Wards	Tokyo 23 Wards Tokyo Central 3 Wards	Tokyo 23 Wards	Tokyo 23 Wards
Building Size	All	All / Large / Small-Medium	All	All	All
Release	Every Quarter				
Data Source	Independently collected by Xymax. Data of available vacant space and building	Independently collected by Xymax. Data of new contract rents including CAM charge.	Independently collected by Xymax. Data of new contract rents including CAM charge.	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	27,699 buildings	962 contracts	1,047 contracts	4,233 contracts	176 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>	<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 a quarterly contract rent by assigning the values of a typical building to the model developed in the preceding step. 3) The outcome from the preceding step based on Q1 2010 as the base point (=100), is the New Contract Rent Index. <p>This model show changes in new contract rents after removing property-specific variables.</p>	<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 data was counted separately into three categories: "rent increase", "no change" or "rent decrease" 2) Calculate the share of buildings with "rent decrease" and buildings with "rent increase". 3) Subtract the share of buildings with "rent decrease" from the share 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 outcome from the preceding step based on Q1 2010 as the base point (=100), is the Paying Rent Index. <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 days. • Ratio of Free Rent Granted The percentage 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 level or closer, but such contracts are excluded from this research.</p>

Appendix

Xymax Research Updates July-October

Office Space per Person 2015 October 20, 2015

- Office space per person in Tokyo 23 Wards in 2015 was 3.87 tsubo, the smallest size since the survey began. This result may be largely influenced by increase in number of workers following the job market recovery.
- Monthly office rent per person in Tokyo 23 Wards finally started to increase in 2015 and marked 65,192 yen.

Paying Rent Index is released October 15, 2015

- Xymax Real Estate Institute developed a new index Paying Rent Index based on the data of lease contracts signed for office buildings in Tokyo 23 Wards.
- Paying rents include not only new rents but also existing rents. It shows how office rents paid by tenants and income from office properties changed over time.

Energy Consumption and Cost in Office Building (June 2015) September 2, 2015

- Energy Consumption: The level in 2011 continued and remained nearly flat.
- Energy Price per Unit: The increase started in 2011 has slowed and the level remained nearly flat.
- Energy Cost: The level remained nearly flat after the second half of 2014.

Electric Power Consumption by Office Tenants (June 2015) September 2, 2015

- Electric power consumption was 34.1 kWh/tsubo in the spring (Apr-Jun) of 2015, only a slight change from 33.8 kWh/tsubo in the same period previous year.

Osaka City New Supply of Office Buildings & Office Stock Pyramid 2015 July 10, 2015

- New supply of office space in Osaka city in 2015-2018 is expected to be an average of approx. 15,000 tsubo per year based on rentable area, which is roughly a half of 31,000 tsubo per year in the last ten-year average.
- Average age of large buildings is 23.3 years influenced by continuous supply after the bubble period. Average age of small/medium buildings is 27.0 years influenced by reduced supply after the bubble period. Future concern is the aging of small/medium building stock which are older than that of large buildings.

Contact

Xymax Real Estate Institute
Phone: +81 3 3596 1477
Fax: +81 3 3596 1478
info-rei@xymax.co.jp