Japan - April 2019

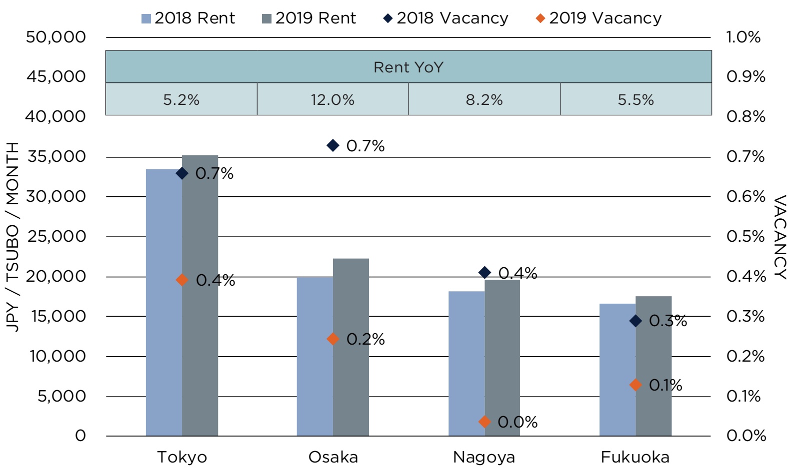
SPOTLIGHT
Savills Research

Regional Japanese Office Markets

savills

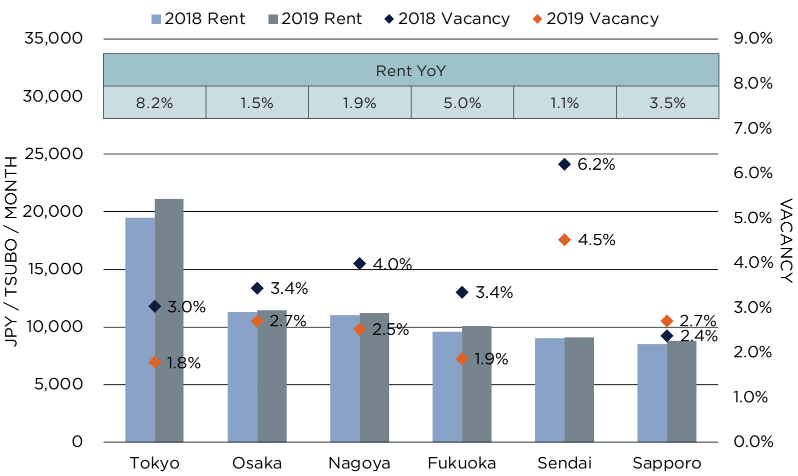
Regional office performance remains strong

GRAPH 1: High-grade Office Performance, 1H/2019



* Tokyo is represented by Grade A office performance in the C5W.
Source Savills Research & Consultancy

GRAPH 2: All-grade Office Performance, 1H/2019



* Market data as of February 2018 and 2019
Source Miki Shoji, Savills Research & Consultancy

HIGH-GRADE OFFICES[1]

Regional high-grade office markets continue to perform well. Strong demand and extremely limited supply have led vacancy to drop to airtight levels. Average high-grade rental growth has cooled somewhat over prior periods, though outer submarkets are picking up strength.

Average high-grade vacancy in the three major markets is now below 0.5%. In Nagoya, vacancy has dropped over 0.3 percentage points (ppts) year-on-year (YoY) and now sits around 4 basis points (bps), while Osaka and Fukuoka saw drops of 0.5ppts and 0.2ppts, respectively.

High-grade rental growth among these markets continues to outpace that of Tokyo Grade A offices (Graph 1). Overall growth appears to be cooling to an extent in Fukuoka and Nagoya, but accelerating somewhat in Osaka. Within each of these cities, YoY growth in multiple outer submarkets exceeded that of the top submarket.

ALL-GRADE OFFICES[2]

With strong corporate demand and extremely limited new supply, the all-grade market has tightened to levels not seen since the early 1990s. Station-front submarkets still lead overall performance, though some outer submarkets are posting stronger rental growth.

Average vacancy is holding below 3% in all markets save Sendai, though vacancy there has now dipped below 5%, the lowest level in over 25 years. With all of Japan's major office markets tightening to record lows, firms are finding it increasingly difficult to secure space for expansions. These conditions have been feeding into strong all-grade rental growth.

Fukuoka and Sapporo saw the highest YoY gain in rents, at 5.0% and 3.5%, respectively, as of February. Growth appears to be slowing somewhat in the top submarkets of most regional cities, likely due to limited leasing activity, while other submarkets are gaining ground. Notably, Sendai YoY rental growth exceeded 1% for the first time since early 2008.

REGIONAL INVESTMENT

Investor appetite for regional assets is growing. The October 2018 investor survey conducted by the Japan Real Estate Institute (JREI) shows that regional cap rates continued to compress even as Tokyo remained flattish in 2018. The largest

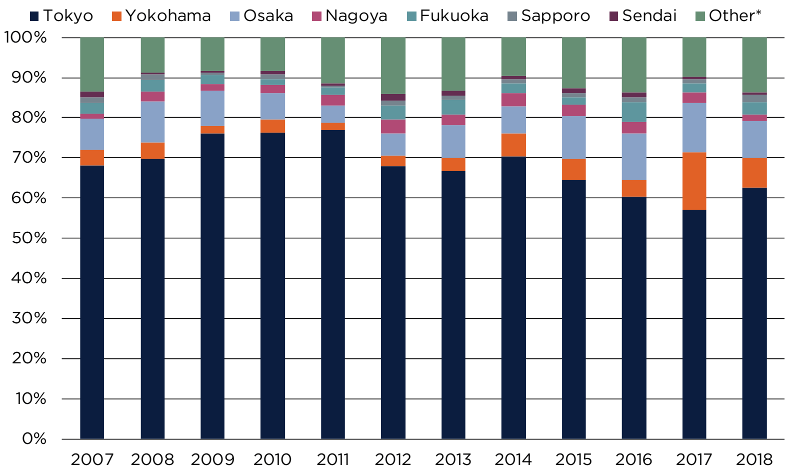
1 In each of Osaka, Nagoya, and Fukuoka, Savills monitors about 50 "high-grade" office buildings typically with a GFA of 15,000+ sq m (4,500 tsubo) and a building age of <25 years.
2 "All-grade" refers to offices typically over 1,000 sq m GFA, depending on the market. Data is sourced from Miki Shoji.

compression was reported for Sapporo and Fukuoka, which saw a 40 basis point (bps) compression YoY, while all other regional markets discussed in our report fell by 20 bps.

According to data from Real Capital Analytics (RCA), total real estate investment volumes for 2018 landed at JPY3.9 trillion, a drop of around 18% over the prior year. A reduction in transaction volumes is largely attributable to limited acquisition opportunities across all sectors. While overall domestic investment volumes have declined, Sapporo, Sendai, and Fukuoka each saw volumes increase compared to 2017. Investment volumes also declined in Osaka, though 2019 has kicked off with a few major office transactions in the market.

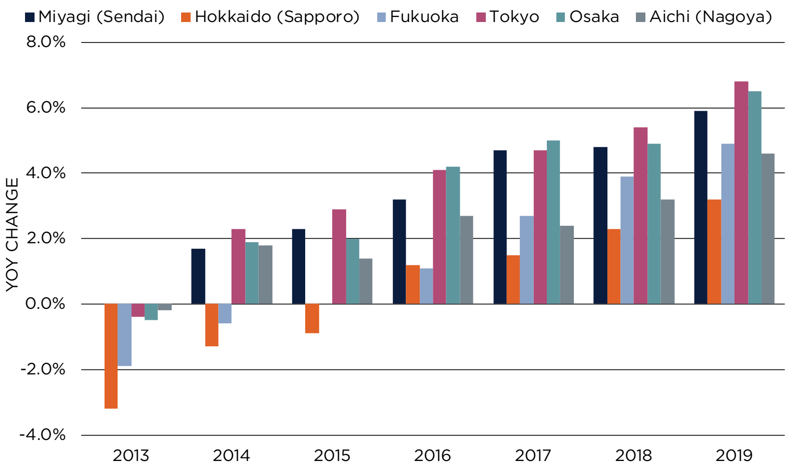
Regional office markets continue to perform well and are attracting more attention from investors. As expected, low tenant turnover has cooled overall rental growth in some top submarkets, though other areas are gaining ground.

GRAPH 3: Investment Volumes By Area For All Asset Types, 2007 to 2018



* "Other" represents portfolio transaction values that have not yet been allocated to specific assets.
Source RCA, Savills Research & Consultancy

GRAPH 4: Chika Koji Commercial Land Prices, 2013 to 2019



Source MLIT, Savills Research & Consultancy

In January, it was announced that GreenOak Real Estate would purchase a 21-property portfolio from Takeda Pharmaceutical at a price rumoured to exceed JPY50 billion. The portfolio spans most of the major regional markets surveyed in this report. The largest of the assets was Takeda's headquarters, the Takeda Midosuji Building located in Osaka, which has a GFA of 32,000 sq m. In the same month, Activia REIT acquired Edge Shinsaibashi, a mixed-use office and retail building near Shinsaibashi Station in Osaka, for JPY19.8 billion. The REIT's sponsor, Tokyu Land, had reportedly purchased the property from Angelo Gordon in July 2018. Limited opportunities and sharp cap rates in Tokyo appear to be incentivising investment in regional markets.

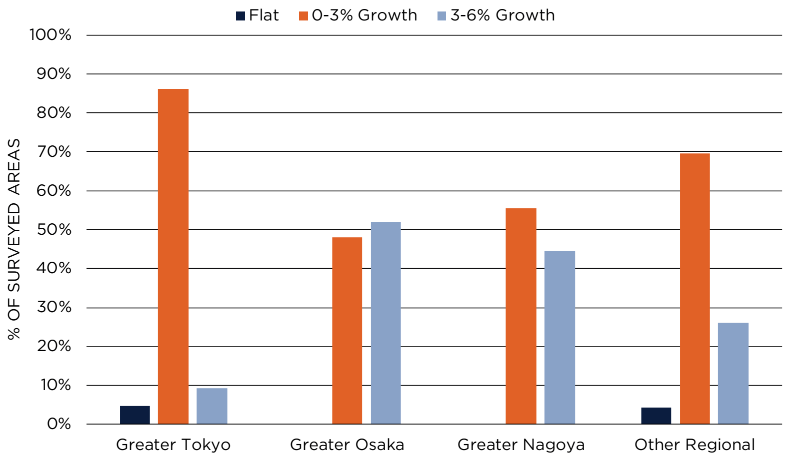
REGIONAL LAND PRICES RISING

The diffusion of investment and development activity outside of Tokyo is supporting growth in land prices across the country. According to the most recent national land value survey (Chika Koji), overall commercial land prices outside of the top three metro areas continued to rise after their growth rates turned positive last year, while residential land prices posted positive YoY growth for the first time in 27 years (Graph 4).

At the prefectural level, Tokyo is still posting the strongest land-price growth; however, land prices at top locations in regional cities now appear to be growing faster. The Ministry of Land, Infrastructure, Transport and Tourism's (MLIT) latest quarterly Land Price Look Report, which tracks the value of 100 "high-use" sites throughout the country, revealed that 97 target sites showed land price increases in Q4/2018. According to the report, land prices at surveyed sites in major regional cities grew at a faster rate than surveyed areas in Tokyo (Graph 5).

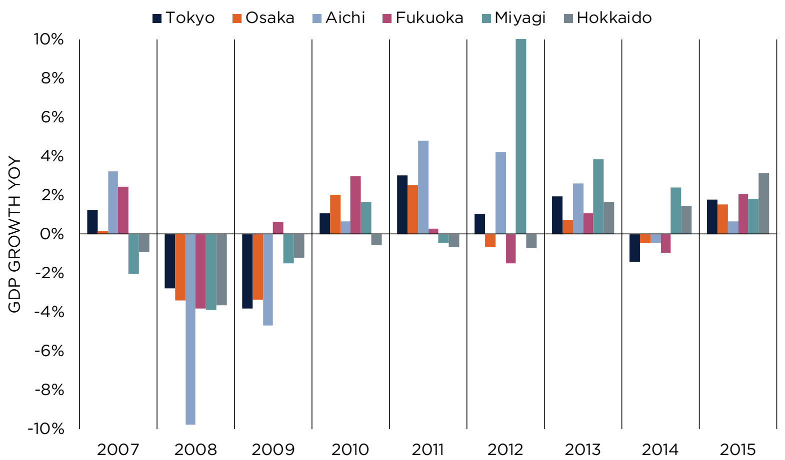
Increases in commercial land prices in regional markets continue to be driven mainly by demand for hotels and retail facilities that can capitalise on rising inbound

GRAPH 5: Land Price Look Report, Q4/2018



Source MLIT, Savills Research & Consultancy

GRAPH 6: Regional GDP Growth, FY2007 to FY2015



Source Prefectural governments, Savills Research & Consultancy

tourism. This has led to polarisation within regional markets, as key tourist destinations and urban centres are seeing much more robust growth, bolstered by strong demand fundamentals. That said, these growth centres appear to be having a ripple effect on other sectors and areas, as revealed by the positive turn in overall regional residential land prices.

REGIONAL MACRO

Regional economies are expanding steadily. The consumption tax hike slated for October warrants some caution for macro conditions; however, the government intends to implement various stimulus measures to reduce the effect on consumption. Interestingly, all regional markets fared better than Tokyo in terms of GDP growth in FY2014, a year which began with the implementation of the previous tax hike (Graph 6).

The Bank of Japan (BOJ) confirmed in its January Regional Economic Assessment that all regional economies continue to either expand or recover (Table 1). Encouragingly, Hokkaido (Sapporo) is recovering from the September 2018 earthquake.

Population declines remain the top concern for the long-term viability of regional economies. However, the cities surveyed in this report serve as the primary economic hubs of their respective regions and have been seeing positive net migration. Sapporo and Fukuoka in particular have been attracting a large number of residents relative to their total populations (Graph 7).

EMPLOYMENT AND DEMAND

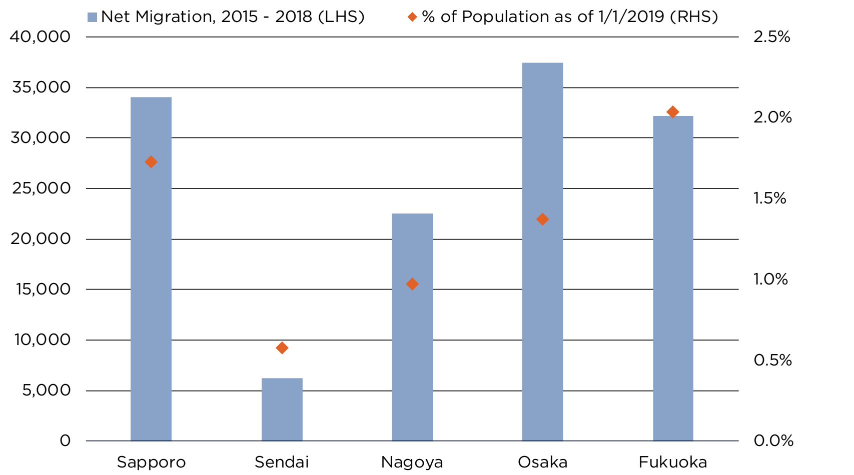
After rising slightly, the national unemployment rate fell back to 2.3% in February. The rate has held within a range of 2.3% to 2.5% since the beginning of 2018,

TABLE 1: BOJ Regional Economic Assessment, January 2019

REGION	TREND	CHANGE VS OCTOBER
Hokkaido (Sapporo)	"Recovering moderately, earthquake induced downward pressure has continued to ease"	↗
Tohoku (Sendai)	"Has continued to recover moderately"	→
Kanto (Tokyo)	"Expanding moderately"	→
Tokai (Nagoya)	"Expanding"	→
Kinki (Osaka)	"Has continued to expand moderately"	→
Kyushu (Fukuoka)	"Expanding moderately, with growth gaining more solid footing"	→

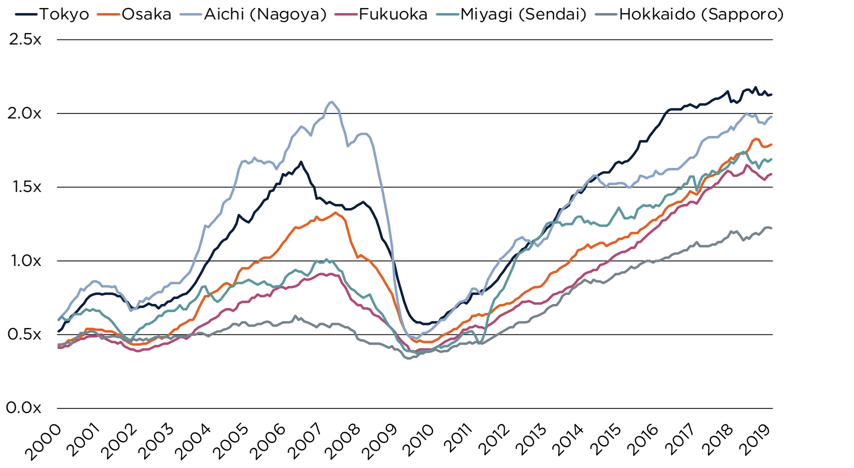
Source Bank of Japan, Savills Research & Consultancy

GRAPH 7: Net Migration To Major Regional Cities, 2015 to 2018



Source Ministry of Internal Affairs and Communications, Municipal Government Websites, Savills Research & Consultancy

GRAPH 8: Job-to-application Ratios, Selected Prefectures, 2000 to February 2019



Source Ministry of Health, Labour, and Welfare, Savills Research & Consultancy

while the national job-to-application ratio has maintained a level at or above 1.6x since May 2018. Indeed, Japan is experiencing an exceptionally tight labour market and competition for talent is fierce.

Corporations continue to show strong labour demand and are aiming to expand offices in regional markets. However, even companies that can secure adequate workforce in this highly-competitive market are having difficulty finding the office space necessary to carry out expansions.

CONVERTING TO CAPITALISE

Regional economies are performing well and companies are looking to strengthen their presence; however, new office supply is essentially limited to the central Tokyo market. As a result, regional office markets are reaching an unprecedented level of tightness. Though office demand is expanding in station-front markets, station-side retail facilities in regional markets are seeing some excess capacity. These conditions have led some players to convert such spaces for office use.

The most notable conversion to date will be implemented at Aeon Shoppers Fukuoka, which will see a total of 3,500 tsubo across three floors converted for office use until 2024, when new supply related to the Tenjin Big Bang Project has fully entered the market.

Retail-to-office conversions are also being carried out in Osaka, notably at E-ma, a retail and cinema complex located near Umeda Station.

Conversions offer the flexibility of adjusting available space based on supply and other market conditions while minimising expenditures. As is ideal for office buildings, urban retail facilities tend to be located within a five-minute walking distance of the nearest station and have large floor plates with relatively open floor plans. Department stores in particular tend to fit these parameters and have so far been the target of such conversions, though other types of retail assets could conceivably be rebalanced to provide office space in high-demand areas.

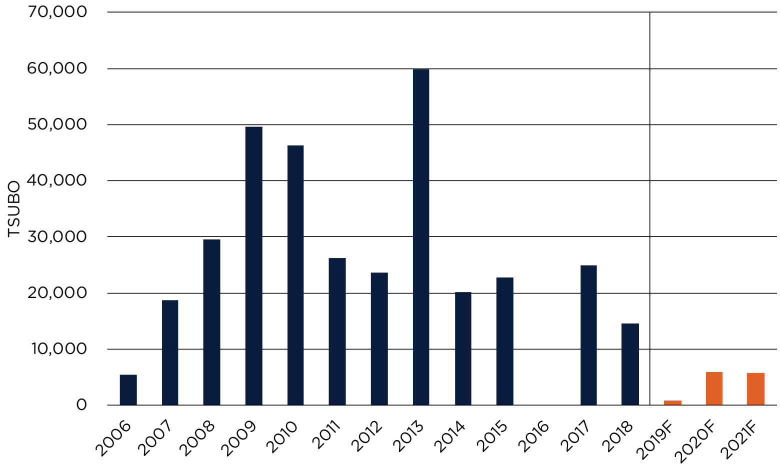
To be sure, this is a newly-emerging trend that is so far limited to select cases in exceptionally tight office markets such as Fukuoka. As major office markets tighten further, some additional players may reposition their assets in order to capitalise on the opportunity. With strong performance across all real estate sectors, however, most property owners may be content just to reap the already-attractive rewards of assets in their current state.

OUTLOOK

Regional office markets are supported by strong fundamentals that are unlikely to wane in the near term without a major external shock. High-grade offices continue to perform exceptionally well, though limited supply and availability for new tenants may be slowing rental growth in top submarkets. All-grade markets are also reaching record levels of tightness and rental growth is picking up, even outside of station-front areas. Net migration to urban centres, as well as booming tourism, should continue to support long-term demand and economic fundamentals in major markets.

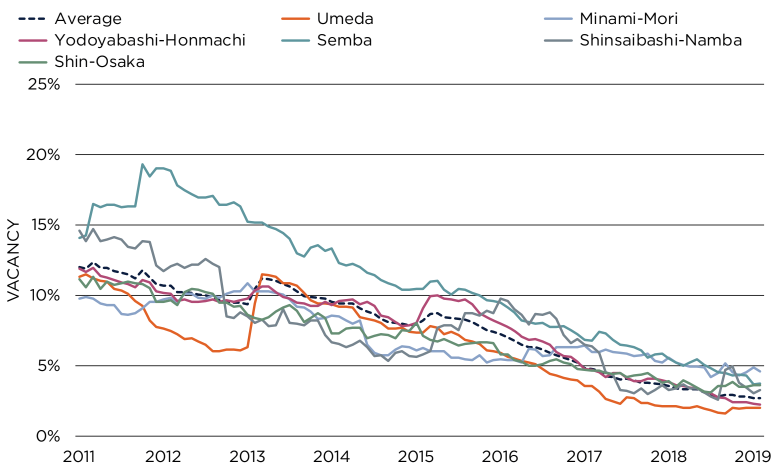
That said, the global economy is becoming increasingly uncertain and some domestic economic indicators are sending cautious signals. Specifically, the Cabinet Office's business condition index for January declined for the third consecutive month, reaching its lowest level since 2013. Moreover, though still at a historically high level, corporate profits posted a decline for the first time in ten quarters, down 7% YoY. Regional office markets have been more vulnerable to economic downturns, as some firms may close branch offices under such conditions; however, extremely limited office supply should mitigate the effects in most regional markets.

GRAPH 9: New NRA Office Supply In Osaka City, 2006 to 2021F



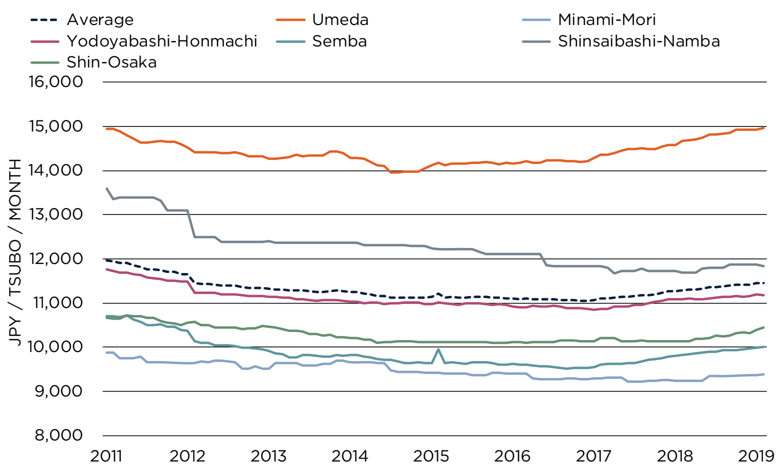
Source Sanko Estate, Savills Research & Consultancy

GRAPH 10: Vacancy Rate In Osaka City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

GRAPH 11: Average Rent In Osaka City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

OSAKA CITY

Net Rentable Area (NRA)

Osaka's total NRA has hovered around 2.2 million tsubo since 2016. With the completion of the Namba Skyo Building in the autumn of last year, no new large-scale supply is expected until the Obic Midosuji Building comes online with 5,900 tsubo of NRA in 2020 in the Yodoyabashi-Honmachi area. Other areas will see some small-scale projects coming online this year.

Supply to the Umeda area, Osaka's top submarket, will be essentially non-existent until Umeda Twin Towers South comes online in 2022, followed by JP Tower Osaka, which is slated for 2023 and will have an office GFA of 41,000 tsubo. Looking further ahead, phase 2 of the massive Umekita Project will add four mixed-use towers with a combined office GFA of 53,000 tsubo over a 17-hectare development site on the northwest side of Osaka Station.

Vacancy

Average high-grade vacancy fell 0.5ppts YoY to 0.2%, as large-scale buildings saw strong leasing demand. All-grade vacancy for Osaka's CBD stood at 2.7% as of February, down 0.7ppts YoY. Semba recorded the most significant tightening, down 1.5ppts YoY to 3.7%. Shin-Osaka was the only submarket to register higher vacancy, up 0.1ppts YoY and all submarkets now have vacancy of less than 5%.

Leasing appears to be strong for those few projects coming online. The Namba Skyo Building reportedly entered the market in September with around 15% vacancy, but has tightened to around 5% as of February 2019. Further, it has been reported that WeWork will lease the entirety of Midosuji Frontier (formerly Midosuji Front Tower) for its second Osaka location. LaSalle Investment Management acquired the 3,500 tsubo NRA office tower, which had been unoccupied since 2010, in October 2018.

Rent

Average high-grade office rents in Osaka have risen 12.0% YoY to stand at JPY22,300 per tsubo per month. Shin-Osaka continues to see strong rental growth, up 17.5% YoY, but was surpassed by Namba, which grew a staggering 21.2% YoY, mainly due to the introduction of the Namba Skyo Building.

All-grade rents in Osaka stood around JPY11,500 per tsubo as of February, representing growth of 1.5% YoY. The average pace of YoY growth appears to be slowing down somewhat. Even so, Shin-Osaka posted exceptional growth of 3.1% YoY, the highest among all Osaka submarkets, while growth in Umeda slowed to 2.0% YoY. All submarkets have seen positive YoY growth since May 2018.

TABLE 2: Osaka Prefecture Key Macro Indicators*

	JAPAN	TOKYO	OSAKA
Real GDP (JPY trillion)	535.3	103.6	38.6
Real GDP (YoY%)	0.8	1.8	1.5
% of Japan (2015)	100%	20%	7%
Population (million)	126.3	13.9	8.8
Job to applicant ratio	1.6	2.2	1.8

Source Cabinet Office, Osaka Prefectural Government, Savills Research & Consultancy
*Real GDP for Japan is as of Q4/2018, for Tokyo, Osaka and % of Japan, 2015.

TABLE 3: Osaka High-grade Office

	1H/2019	HOH	YOY
Rent	22,300	7.7%	12.0%
Vacancy	0.2%	-0.6ppts	-0.5ppts
Top Rent	35,000+	0	+3,000

Source Savills Research & Consultancy

Umeda
High-grade rents in Umeda and Nakanoshima range from JPY20,000 to over JPY35,000 per tsubo per month. Though top and bottom rents have remained flattish since the previous report, YoY growth in Umeda averaged 12.8%. As vacancy is now at 0.1%, more landlords are pushing towards top-level rents, with a bidding system for potential lessees rumoured to have been introduced.

Yodoyabashi-Honmachi
High-grade rents in Yodoyabashi and Honmachi range from JPY13,000 to JPY28,000 per tsubo per month. Rents have risen at the lower and higher ends of the range. As of February, all-grade vacancy in the submarket stood at 2.3%, down 1.4ppts YoY. Despite seeing the second largest YoY drop in vacancy, all-grade rental growth in the area, at 0.7% YoY as of February, remains the weakest among all submarkets.

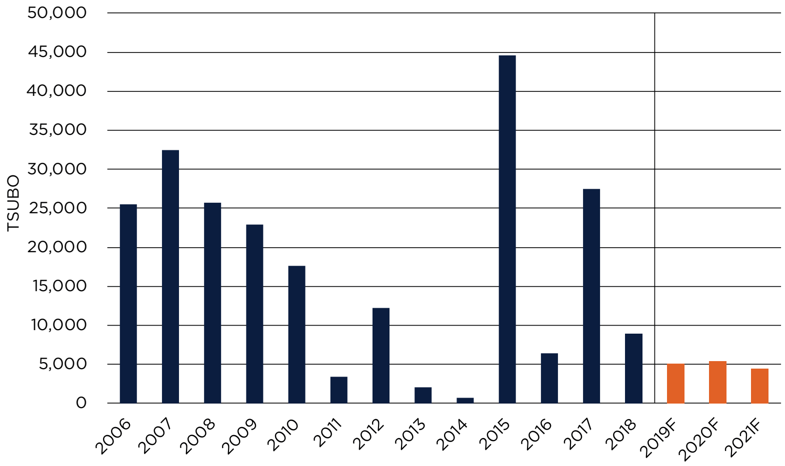
Nippon Life Insurance announced the tentatively-named Shin-Yodoyabashi Building Development Project, which will redevelop the existing structure, the Nihon Seimei Yodoyabashi Building, into a 25F mixed-use tower with a GFA of 15,500 tsubo. Slated for completion in 2022, it will be the tallest office building in the Yodoyabashi area.

Shin-Osaka
High-grade rents in Shin-Osaka range from JPY16,000 to JPY27,000 per tsubo per month. Top and bottom rents have risen by JPY2,000, with average rents growing rapidly, up 17.5% YoY. All-grade rental growth appears to have responded in kind, up 3.1% YoY, the highest rate of growth on record according to Miki Shoji.

Outlook
With office supply very limited, extremely tight office vacancy conditions should persist for at least the next two years, while top high-grade rents, still below 2008 levels, likely have room for further growth. Upcoming events and developments should continue to support the local economy and foster demand, even as new large-scale developments come online in 2022 and beyond.

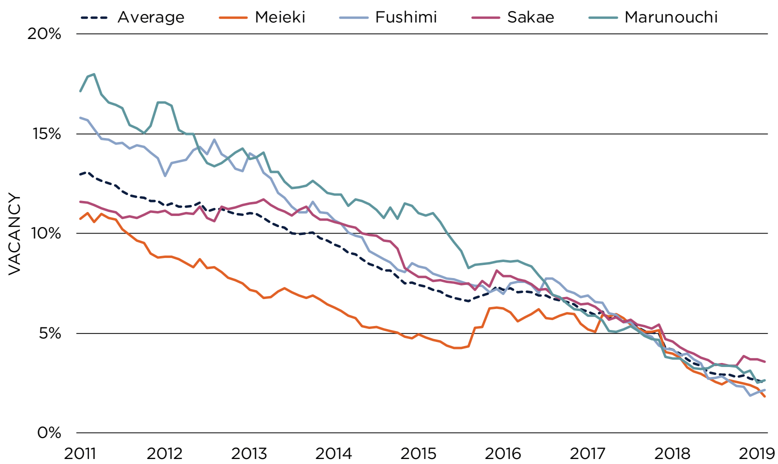
Osaka has been selected to host the 2025 World Expo, which will attract visitors and serve as a platform for the Keihanshin area to showcase its industries. The government estimates that the event will draw 28 million attendees and add JPY2 trillion to the national economy. Osaka is also aiming to have an integrated resort up and running in time for the event. These catalysts should expedite infrastructure projects, including an extension of the subway line, making Osaka more attractive.

GRAPH 12: New NRA Office Supply In Nagoya City, 2006 to 2021F



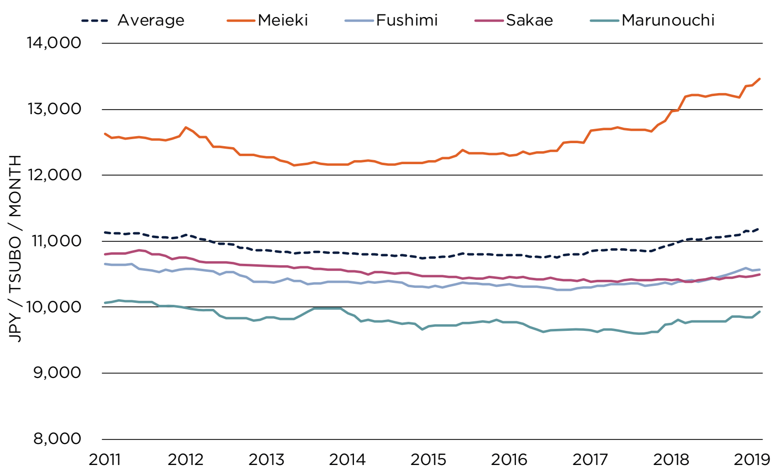
Source Sanko Estate, Savills Research & Consultancy

GRAPH 13: Vacancy Rate In Nagoya City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

GRAPH 14: Average Rent In Nagoya City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

NAGOYA CITY

NRA

Total NRA in Nagoya stood at just under 1.0 million tsubo as of February, dropping slightly as a result of demolitions in preparation for redevelopment. New buildings coming online over the next three years will be relatively small and total volume is expected to be far below that of the 2015-2018 period. In April, Aeon Mall announced its first mixed-use retail and office facility, due for completion in 2021 as a part of the Noritake Forest Project. Office floor plates are rumoured to be 2,000 tsubo; however, such details have yet to be confirmed.

Most incoming supply between now and 2021 will be concentrated in Meieki, though development is also shifting outward. The tentatively-named Kajima Fushimi Building, due in October, will add 3,200 tsubo of office NRA to the market with 260 tsubo available per floor. A new landmark for the Fushimi area, this will be the first high-grade office building that the submarket has seen since 2012.

Moreover, the Sakae area has been designated as an urban revitalisation district, which is already supporting major upcoming projects. NTT Urban Development's project to reconstruct the former Sumitomo Corporation Nagoya Building, for example, has been approved under the new designation, allowing the current 13F structure to be developed into a 20F office building by early 2022. In February, details were released regarding the redevelopment of the Chubu Nippon Building. Scheduled for completion in 2024, the project will convert the current B4/12F structure into a B4/31F mixed-use tower with a GFA of over 34,000 tsubo.

Vacancy

High-grade vacancy in Nagoya remains the tightest of the three submarkets covered, dropping an additional 0.2ppts over the half year and now sitting at 4bps. With already-airtight vacancy in the high-grade Meieki market, outer submarkets saw a steady stream of leasing and have fallen to near-zero levels.

All-grade vacancy continues to tighten rapidly, down 1.5ppts YoY to sit at 2.5% as of February. All surveyed submarkets save Sakae posted vacancy below 3.0%. There is still room for compression in the all-grade market, particularly as high-grade space is severely limited.

Rent

High-grade office rents grew by 8.2% YoY on average, led by the Fushimi and Marunouchi markets, which posted significant growth of 17.6% and 12.6%, respectively. This represents a major shift in the Nagoya office market,

TABLE 4: Aichi Prefecture Key Macro Indicators*

	JAPAN	TOKYO	AICHI
Real GDP (JPY trillion)	535.3	103.6	37.4
Real GDP (YoY%)	0.8	1.8	0.7
% of Japan (2015)	100%	20%	7%
Population (million)	126.3	13.9	7.5
Job to applicant ratio	1.6	2.2	1.9

Source Cabinet Office, Aichi Prefectural Government, Savills Research & Consultancy
*Real GDP for Japan is as of Q4/2018, for Tokyo, Aichi and % of Japan, 2015.

TABLE 5: Nagoya High-grade Office

	1H/2019	HOH	YOY
Rent	19,600	5.1%	8.2%
Vacancy	0.0%	-0.2ppts	-0.4ppts
Top Rent	36,000+	+1,000	+1,000

Source Savills Research & Consultancy

which has until now seen rental growth dominated by the station-side Meieki area.

The all-grade market, on the other hand, continues to be led by Meieki, which saw rents grow 3.7% YoY to land at JPY13,500. Indeed, at JPY11,200, Nagoya all-grade rents are far below the high-grade average, and growth rates are similarly more modest, averaging 1.9% YoY. Encouragingly, rents in Sakae appear to have bottomed out, posting their highest YoY growth since January 2009.

Meieki

Asking rates for station-side tower locations now range from JPY34,000 to over JPY36,000. Availability in these locations has been exceptionally limited for the past year and existing tenants are expected to pay higher rents. Specifically, it is expected that original tenants in one tower could see rents adjusted by as much as JPY10,000 per tsubo upon contract renewal to match the above rates.

Rents for large-scale offices in the area range between JPY20,000 and JPY30,000 per tsubo per month, with top rents rising JPY5,000 over the prior period.

Fushimi and Marunouchi

High-grade rents in Fushimi and Marunouchi now range between JPY15,000 to JPY24,000 per tsubo per month. Top asking rents grew JPY4,000 over the half year as a landmark building in the Fushimi area raised rents by 20%, though buildings across the high-grade spectrum have also seen substantial rental growth in both markets.

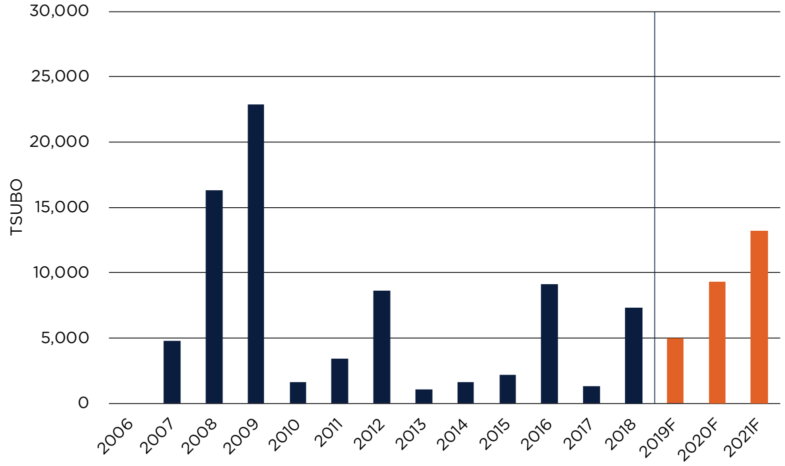
All but one floor of the Kajima Fushimi Building is rumoured to have been preleased, with the remaining floor being listed at JPY23,000, around JPY3,000 higher than when preleasing began.

Outlook

While high-grade rents in the Meieki district still command a JPY10,000+ premium over surrounding markets, a prolonged period of airtight vacancy appears to have finally had a ripple effect on nearby submarkets, with Fushimi and Marunouchi posting exceptional YoY growth. The all-grade market also appears to have benefitted from limited high-grade availability, though gains have so far been largely concentrated in Meieki.

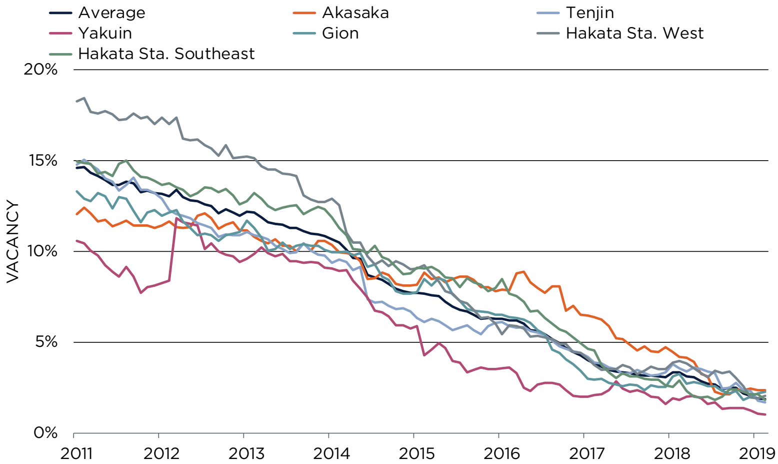
With upcoming supply limited and strong demand, particularly in Meieki and Fushimi, rents should continue to rise. Relocations due to development of the Linear Chuo Shinkansen (maglev) station should tighten the station-side market even further, while redevelopment in other submarkets, notably Sakae, should improve the attractiveness of offices beyond the station area.

GRAPH 15: New NRA Office Supply In Fukuoka City, 2006 to 2021F



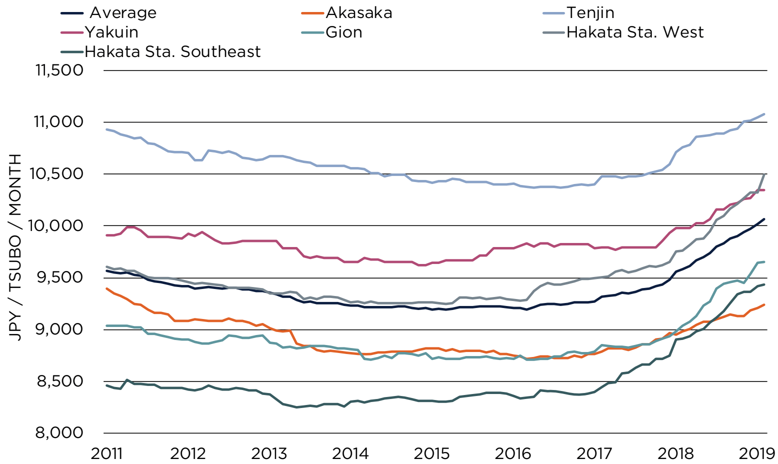
Source Sanko Estate, Savills Research & Consultancy

GRAPH 16: Vacancy Rate In Fukuoka City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

GRAPH 17: Average Rent In Fukuoka City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

FUKUOKA CITY

NRA

Total office NRA currently sits at 0.7 million tsubo, though this should steadily increase over the coming decade as a result of the "Tenjin Big Bang" revitalisation project, which aims to rebuild 30 buildings by 2024. Although it appears unlikely that this ambitious goal will be reached, available disclosures suggest that Fukuoka's office supply pipeline over the next few years is the strongest of all regional cities surveyed in this report.

Construction of the first large-scale development under the project, the Tenjin Business Centre, began in January and is expected to complete in September 2021, offering 18,500 tsubo GFA across 19 floors, three greater than initially planned, thanks to relaxed height restrictions. The next Tenjin Big Bang development, the Fukuzakuri Redevelopment Project, is expected to add 30,000 tsubo GFA when it completes in 2023.

While the market waits for new supply, a severe lack of available office space has led some landlords to repurpose other spaces for office use, as with Aeon Shoppers Fukuoka, which will convert a total of 3,500 tsubo for office use until 2024. Under its "Re Biru" operation, Mitsubishi Estate completed renovation of the Park Rex Hakata, which is owned by the Nikkei, converting a large area that held a printing press into a multi-floor retail and office space.

Vacancy

High-grade vacancy in Fukuoka tightened 0.2ppts YoY to 0.1%, while the average all-grade vacancy rate fell 1.5ppts to 1.9% as of February 2019. The Akasaka, Tenjin, and Hakata Station West areas all saw vacancy drop around 2.0ppts YoY. Fukuoka office demand is spreading beyond the top station-side markets and gains are becoming more distributed.

In early 2019, WeWork unveiled a second Fukuoka location with 550 seats in Nakasu, adding to its 350 seat location in Daimyo, which opened in December 2018. Makuake, one of Japan's largest crowdfunding companies, will open its first Fukuoka office to better serve Kyushu-based startups.

Rent

Average high-grade office rents in Fukuoka rose 5.5% YoY to stand at JPY17,600 per tsubo per month. While still strong, growth is lagging behind that of Osaka and Nagoya. Limited leasing activity due to extremely tight conditions is likely tempering average rents in the high-grade market.

All-grade rental growth, on the other hand, continues to outpace all other markets in

TABLE 6: Fukuoka Prefecture Key Macro Indicators*

	JAPAN	TOKYO	FUKUOKA
Real GDP (JPY trillion)	535.3	103.6	18.2
Real GDP (YoY%)	0.8	1.8	2.1
% of Japan (2015)	100%	20%	4%
Population (million)	126.3	13.9	5.5
Job to applicant ratio	1.6	2.2	1.6

Source Cabinet Office, Fukuoka Prefectural Government, Savills Research & Consultancy
*Real GDP for Japan is as of Q4/2018, for Tokyo, Fukuoka and % of Japan, 2015.

TABLE 7: Fukuoka High-grade Office

	1H/2019	HOH	YOY
Rent	17,600	1.5%	5.5%
Vacancy	0.1%	-0.3ppts	-0.4ppts
Top Rent	25,000+	+2,000	+2,000

Source Savills Research & Consultancy

our survey, rising 5.0% YoY as of February, with the Hakata Station West submarket posting growth of 7.4%, the highest of all 26 submarkets surveyed in this report. The average all-grade rent stood around JPY10,100, the highest level since 2003.

Station Front

High-grade rent around Hakata Station averages JPY18,700 per tsubo per month, ranging from JPY17,000 to over JPY25,000. Top rents have grown JPY2,000 over the prior period and now surpass those of Tenjin. The Fukuoka City government announced initial plans for "Hakata Connected" in January, which will promote the redevelopment of 80 hectares of space within a 500-metre radius of Hakata Station. Further details have yet to be released, though as with the Tenjin Big Bang, building height restrictions are expected to be loosened.

Tenjin

High-grade rent in the Tenjin area has grown rapidly to range between JPY14,000 and JPY24,000 per tsubo per month. Top rents grew by JPY1,000 over the prior period, though some landlords are rumoured to have negotiated rents as high as JPY25,000 for certain tenants.

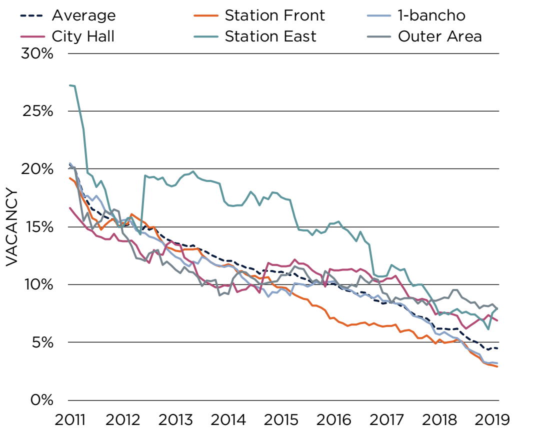
Outlook

Fukuoka's office market has strengthened faster than any other market in our survey over the past two years. While growth in average high-grade rents has slowed down somewhat, likely due to limited availability, average all-grade rental growth is maintaining a strong pace and submarkets that were previously lagging behind have quickly gained ground over the past year.

The city government's efforts to bolster the local economy, namely ongoing support for redevelopment projects, including Waterfront Next and a proposed ropeway connecting Hakata Station and Hakata Port, and measures to attract startups and entrepreneurs, both foreign and domestic, will help solidify the city as a regional business centre. Better quality of supply and greater demand from businesses should continue to support office rents.

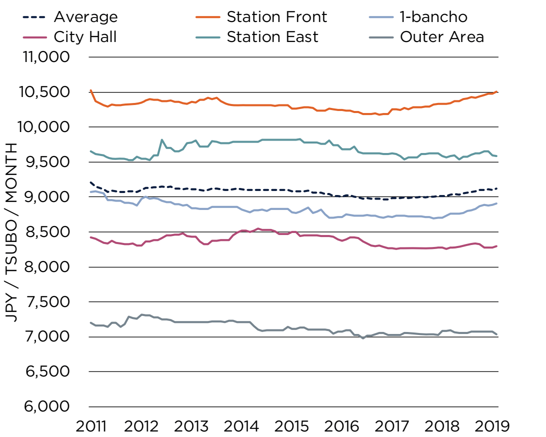
To be sure, some local brokers and building owners are concerned that the high levels of supply coming online with the Tenjin Big Bang might soften this bull market. Even now, some outlying areas, such as Momochihama, are still having difficulty filling space. Further, though the Fukuoka office market is in an earlier phase of its upswing, the overall economic upswing is well extended. That said, fundamentals are strong in Japan's fastest growing large city and the market is unlikely to see a significant reversal without an external shock.

GRAPH 18: Vacancy Rate In Sendai City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

GRAPH 19: Average Rent In Sendai City, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

SENDAI CITY

Supply and Demand

As of February 2019, Sendai's office market stood at just under 0.5 million tsubo NRA, with total stock declining slightly in recent months due to demolitions. In the wake of the 2011 disaster, much of the office supply to the Sendai market has involved reconstruction of small-scale, older buildings to implement improved earthquake protection standards.

With the office market tightening rapidly over the past two years, however, more landowners are looking to redevelop other property types into offices and increase the scale of existing structures. The tentatively-named Sendai Kakyoin Project, for example, will convert a parking lot into a 9F office building with a GFA of over 1,800 tsubo. Other projects, such as the Miyako Shinkin Bank Building due in June 2019, will replace two older office buildings on the same lot, while the reconstruction of the Shin-Sendai Building will add around 3,400 tsubo of GFA, 25% more than that of the original building. JR East is also planning an office development on the east side of Sendai Station, which is set to add 7,500 tsubo of GFA in 2021.

Demand from large firms establishing branch offices continues to support the market. However, with very limited available space that meets the floor plate and location requirements of such tenants, particularly those looking to establish call centres, some companies have reportedly abandoned plans to open offices in Sendai.

The recent expansion of serviced offices and co-working in the market via Regus and Enspace, a new player in Northern Japan, could offer some flexibility for certain tenants. Moving forward, some landlords may begin converting portions of other existing properties into office space, as is becoming increasingly common in Fukuoka.

Vacancy

Sendai's average all-grade vacancy rate fell by 1.7ppts YoY to 4.5% as of February, the lowest level recorded since Miki Shoji's survey began in 1992. The Station Front and 1-bancho submarkets exhibit the tightest vacancy, at 3.0% and 3.2%, respectively. Vacancy in the Outer Area, now at 7.9%, tightened 1.0ppts YoY, revealing that demand is picking up somewhat away from Sendai Station.

Rent

Average all-grade rents in Sendai rose 1.1% YoY to reach 9,100 per tsubo per month. Led by the Station Front and 1-bancho markets, rental growth has been steadily picking up pace across all submarkets since mid-2017, with YoY growth at its highest level since May 2008. All but the Outer Area submarket posted YoY growth as of February.

Outlook

Although office supply is severely limited, more companies are looking to open offices in Sendai. The city is located approximately 1.5 hours away from Tokyo by Shinkansen (bullet train) and favourable business policies are drawing in more tenants. These factors also make the city ideal for companies looking to diversify geographically out of business continuity planning considerations. However, the average leasable area of currently-available stock in Sendai does not meet the requirements of some large firms looking to open new offices.

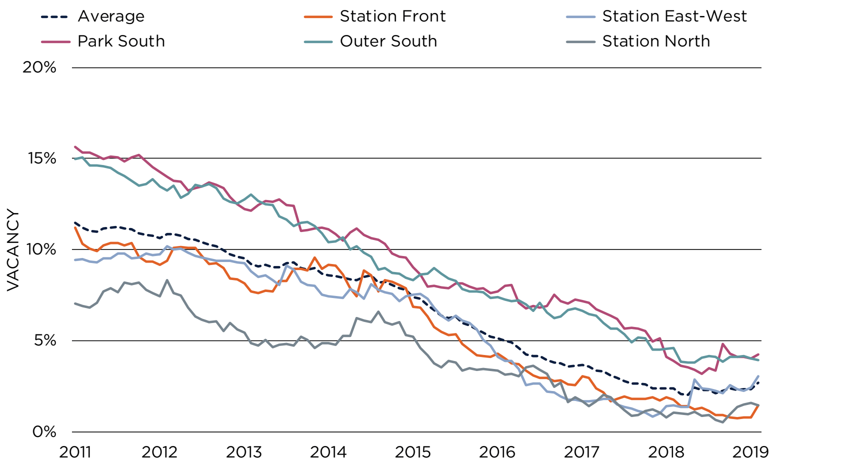
Indeed, according to Miki Shoji's data, average space available per building with vacancy is now less than 100 tsubo. New supply slated to come online over the next three years will offer larger floor plates with more NRA, providing some flexibility for tenants. In the meantime, however, some firms may have to compromise somewhat on leasing conditions or seek out space beyond the Sendai market.

TABLE 8: Miyagi Prefecture Key Macro Indicators*

	JAPAN	TOKYO	MIYAGI
Real GDP (JPY trillion)	535.3	103.6	9.3
Real GDP (YoY%)	0.8	1.8	1.8
% of Japan (2015)	100%	20%	2%
Population (million)	126.3	13.9	2.3
Job to applicant ratio	1.6	2.2	1.7

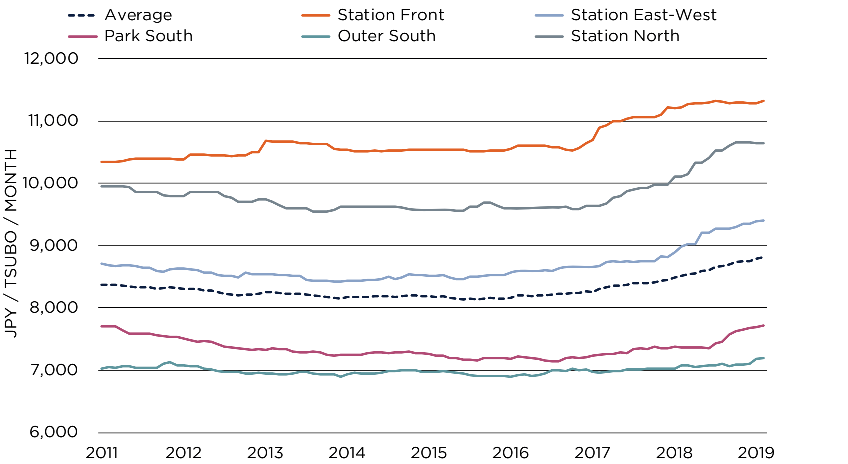
Source Cabinet Office, Miyagi Prefectural Government, Savills Research & Consultancy
*Real GDP for Japan is as of Q4/2018, for Tokyo, Miyagi and % of Japan, 2015.

GRAPH 20: Vacancy Rate In Sapporo City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

GRAPH 21: Average Rent In Sapporo City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

SAPPORO CITY

Supply and Demand

Sapporo's total office NRA is approximately 0.5 million tsubo, a figure which has remained relatively stable over the last decade. Over half of existing stock is located immediately to the south of Sapporo Station and along Odori Park.

2019 will see the completion of a few small-scale projects. The Sousei East Building (formerly the S1E3 Building) will be completed in the Outer South submarket in March. According to a local agent, all 670 tsubo of office NRA has been preleased. Minami Odori Building Ichijo is next in the pipeline, due for completion in April with 2,800 tsubo of GFA, and offers around 317 tsubo of NRA per office floor.

Sapporo office demand has been largely driven by IT firms establishing branch offices and call centres. However, the Bioinformatics, Medical IT, and Medical equipment industries are also becoming more prominent and the city is working to promote these businesses by hosting industry conferences and offering financial incentives to those looking to start such businesses in the city.

The local government is also offering subsidies to attract corporate headquarters to the city, providing up to JPY60 million for headquarters relocation and JPY20 million per year for three years to help cover human resources expenditures. These incentives appear to be working: for example, Tokyo-based Diamond Head, an e-commerce web design firm, opened a headquarters on the 14th floor of Sapporo Sousei Square in November with 88 employees and plans to further expand to accommodate an additional 112 employees over three years.

TABLE 9: Hokkaido Prefecture Key Macro Indicators*

	JAPAN	TOKYO	HOKKAIDO
Real GDP (JPY trillion)	535.3	103.6	18.3
Real GDP (YoY%)	0.8	1.8	1.1
% of Japan (2015)	100%	20%	4%
Population (million)	126.3	13.9	5.3
Job to applicant ratio	1.6	2.2	1.2

Source Cabinet Office, Hokkaido Prefectural Government, Savills Research & Consultancy
*Real GDP for Japan is as of Q4/2018, for Tokyo, Hokkaido and % of Japan, 2015.

Vacancy

The average all-grade vacancy rate for Sapporo as of February 2019 was 2.7%, a 0.3 ppts rise YoY. Vacancy in the Station Front submarket fell 1.1ppts to land at 0.8% as of January; however, vacancy ticked up to 1.5% - still down 0.3 ppts YoY - as of February, reportedly due to a large tenant moving to a company-owned building. All other markets other than the Outer South posted YoY increases in vacancy. Lack of sufficient space may be preventing new tenants from entering the market.

According to Miki Shoji's data, Sapporo Sousei Square, which is located in the East-West submarket, still appears over 20% vacant, though this figure has been falling steadily since the building opened in May 2018.

Rent

All-grade rental growth has been accelerating since early 2016, reaching 3.5% YoY in February. Station North posted the largest growth of 5.2% YoY, followed closely by Park South and Station East-West at 4.8% and 4.7%, respectively. Rental growth in the Station Front market, however, has slowed to 0.9% YoY.

Station Front rental growth picked up during the year following the completion of the Sapporo Fukoku Seimei Koshiyama Building in January 2017, but has gradually slowed since, likely due to limited space for relocations. The Station East-West market still appears to be gaining momentum from the completion of Sapporo Sousei Square. The completion of the Daido Seimei Sapporo Building early next year could reignite the Station Front market.

Outlook

Limited supply and steady demand have led the Sapporo market to have the second highest YoY rental growth among cities surveyed. Indeed, as the largest city in Northern Japan, Sapporo remains an attractive business centre and net migration is strong. The recent completion of La Tour Sapporo Ito Garden, a luxury apartment building near Sapporo Station that offers 330 units – crowned by a penthouse that will be rented for JPY850,000 per month – is indicative of the city's growing prosperity.

Sapporo is also looking to host the Winter Olympics in 2030, which – along with the completion of the Hokkaido Shinkansen Line extension – should promote further development in the long term. In the near term, modest supply of new office buildings with higher specifications should add some vitality to the market and support rent growth, without overcrowding the market.

That said, the market has so far relied on the establishment of branch offices, which might be closed in a downturn. Efforts by the local government to draw in more corporate headquarters and larger offices should help reduce the blow to the market when the global economy turns south.

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For more information about this report, please contact us

Savills Japan

Christian Mancini
CEO, Asia Pacific
(Ex. Greater China)
+81 3 6777 5150
cmancini@savills.co.jp

Savills Research

Tetsuya Kaneko
Director, Head of Research
& Consultancy, Japan
+81 3 6777 5192
tkaneko@savills.co.jp

Simon Smith
Senior Director
Asia Pacific
+852 2842 4573
ssmith@savills.com.hk