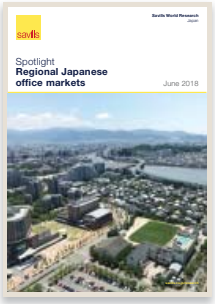
savills

Savills World Research
Japan

Spotlight
Regional Japanese office markets

June 2018

Spotlight
Regional Japanese office markets



"High-grade offices in major regional cities have seen a spike in rents while average all-grade rents have risen for all markets surveyed. All-grade vacancy in every surveyed city has fallen to levels not seen since the early 1990s. In the absence of an external shock, these trends are likely to continue."

High-grade offices[1]

High-grade office buildings in Osaka, Nagoya and Fukuoka have performed especially well in the first half of 2018. Rents have jumped as vacancies tightened to record lows due to high demand and limited new supply. Landlords who were once hesitant to raise contract rates now appear to be confident that tenants will accept higher rents.

High-grade vacancy now sits below 1% in all three major markets. Osaka and Fukuoka's minimal new supply has come online in late 2017 and early 2018 with most buildings fully leased as of opening. Supply will continue to be limited until at least 2020.

Average high-grade rents have spiked in all three surveyed cities, as record low vacancy and strong demand for premium space have enabled landlords to increase asking rates. Rents for premium buildings in Osaka are up 11.9% year-on-year (YoY), while Nagoya's rates have increased 8.7%. Fukuoka's rents have also increased an impressive 12.4% over the same period.

All-grade offices[2]

Data from Miki Shoji reveals an uptick in average all-grade rental growth in all major regional markets. While major transit hubs are still seeing the strongest all-grade growth, surrounding submarkets are beginning to swing upwards.

Vacancy is trending even tighter, and has now reached 4% or lower in every city save Sendai. Most all-grade markets have yet to reach the ultra-tight conditions of high-grade markets, but are likely to improve further. As high-grade vacancy has fallen below 1% in Osaka, Nagoya and Fukuoka, relocation is presenting a challenge to tenants. Limited premium space in central areas and light incoming supply should continue to drive down vacancies in the all-grade market.

Rents appear to have finally responded to this supply-demand dynamic, with 24 of the 26 submarkets surveyed posting YoY growth. Sapporo's Station North saw a gain of 5.5% YoY, the highest of all surveyed submarkets, while Fukuoka saw the highest average growth overall at 3.7% YoY.

Investor appetite

According to a semi-annual survey by the Japan Real Estate Institute (JREI), regional cap rates have been compressing in most cities. Regional cities are still showing yield gaps of 1.0 to 2.0 percentage points (ppts) over Tokyo, but actual market yield gaps have been tighter.

Investor appetite remains robust, with 1.5 trillion yen of investment recorded for Q1/2018. Transaction data from Real Capital Analytics (RCA) suggests that Tokyo's share of total real estate investment has declined since 2014, though Q1/2018 saw its share increase relative to regional markets. While Yokohama has recently received the lion's share of investment outside of Tokyo, Nagoya saw a significant increase in

TABLE 1

High-grade office performance, Spring 2018

	Vacancy	YoY ppts	Rent	YoY
Osaka	0.7%	-1.1	19,900	+11.9%
Nagoya	0.4%	-2.0	18,100	+8.7%
Fukuoka	0.3%	-0.1	16,600	+12.4%

Source: Savills Research & Consultancy

TABLE 2

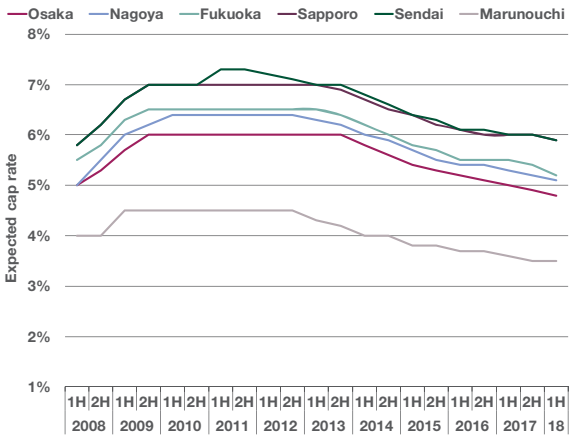
All-grade office performance, Spring 2018

	Vacancy	YoY ppts	Rent	YoY
Osaka	3.4%	-0.9	11,300	+1.7%
Nagoya	3.4%	-2.5	11,000	+1.4%
Fukuoka	3.1%	-0.5	9,700	+3.7%

Source: Miki Shoji, Savills Research & Consultancy

GRAPH 1

Regional cap rates, 1H/2008 – 1H/2018



Source: JREI, Savills Research & Consultancy

1 In each of Osaka, Nagoya, and Fukuoka, Savills monitors 40-50 "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.

investment volume for the quarter, with notable transactions in the office, retail and hospitality sectors.

According to the most recent national land value survey (Chika Koji), overall commercial land values outside of greater Tokyo, Osaka, and Nagoya have increased for the first time in 26 years. While overall regional growth registered a modest increase of 0.5%, major regional cities and urban centres greatly outperformed. Most notably, average commercial land values in the cities of Sapporo, Sendai, Hiroshima, and Fukuoka grew 7.9% YoY.

For the major metropolitan markets, growth in commercial land values in Greater Osaka outpaced that of Greater Tokyo, coming in at 4.7% YoY vs. Tokyo's 3.7%, while Greater Nagoya posted a 3.3% increase.

Growth in regional land values is undoubtedly led by demand for hotel and retail properties in light of booming tourism, particularly in Greater Osaka. Even so, increasing rents in the office market are further boosting profitability of commercial property, thereby raising overall value.

Regional macro

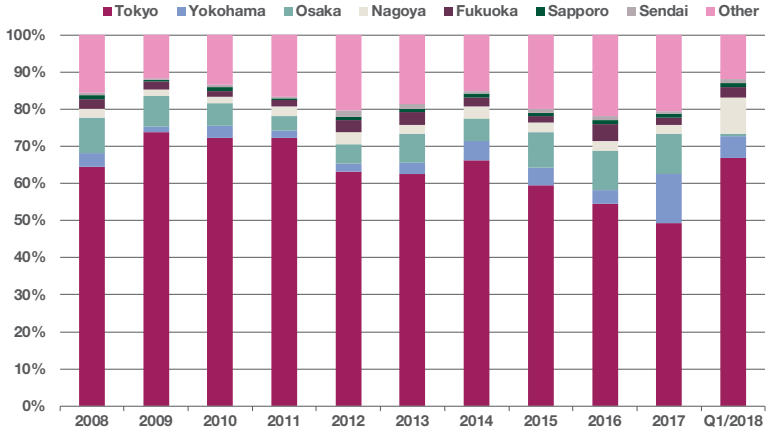
Japan's regional economies are expanding. Corporate performance continues to strengthen and inbound tourism is reaching new highs, while the national government pushes measures to stimulate local business. The Bank of Japan (BOJ), in its April Regional Economic Assessment, pronounced an "expanding" or "recovering" trend in all nine surveyed geographies (Table 3). While Hokkaido's (Sapporo) expansion has slowed somewhat since the BOJ's prior assessment in January 2018, Kyushu (Fukuoka) is now experiencing stronger growth.

Expanding tourism

Increasing inbound tourism to Japan is by now no secret. Provisional figures indicate that the number of annual foreign visitors for 2017 exceeded 28.5 million while total spending by such visitors surpassed 4.4 trillion yen, rising nearly 18% over the prior year.

GRAPH 2

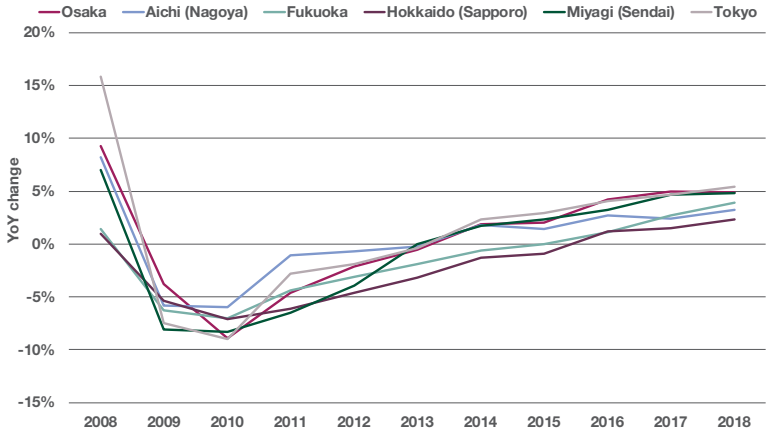
Investment volumes by area for all asset classes, 2008 – Q1/2018*



Source: RCA, Savills Research & Consultancy
* Investment volumes presented exclude transactions where specific locations have not been identified.

GRAPH 3

YoY change in commercial land values by prefecture, 2008 – 2018



Source: Ministry of Land, Infrastructure, Transport and Tourism (MLIT), Savills Research & Consultancy

TABLE 3

BOJ regional economic assessment, Apr 2018

Region	Trend	Change vs January
Hokkaido (Sapporo)	"Has been recovering moderately"	↘
Tohoku (Sendai)	"Has continued to recover moderately"	→
Kanto (Tokyo)	"Expanding moderately"	→
Tokai (Nagoya)	"Expanding"	→
Kinki (Osaka)	"Expanding moderately at a steady pace"	→
Kyushu (Fukuoka)	"Expanding moderately, with growth gaining more solid footing"	↗

Source: Bank of Japan, Savills Research & Consultancy

Although Tokyo remains the top destination, Japan's regional cities have also become popular among foreign travellers. Osaka and Hokkaido have taken second and third place for room nights, topping 11.7 and 7.4 million nights, respectively, while Fukuoka and Aichi (Nagoya) have had clear gains over the past several years. Miyagi's (Sendai) total figures may appear meagre in comparison; however, the number of nights spent by foreign visitors annually has nearly quintupled since 2011.

Heavy inbound tourism to Osaka in particular has boosted commercial land values, favouring retail over office districts. As a result, the most expensive land in Osaka by Koji Chika has moved from the Kita ward (Umeda) to the Chuo ward (Shinsaibashi) for the first time.

Business, employment and demand

Rising corporate profits and a very tight labour market continue to be major drivers of office demand.

The national unemployment rate has fallen to 2.5%, 0.3ppts lower than the October 2017 figure and the lowest rate on record since March 1993. Job-to-application ratios in the country's regional markets continue to rise, reaching 1.59 job openings per applicant nationwide as of March. While the job-to-application ratio in Tokyo remains the highest at 2.07x, the level has largely stabilised since early 2016. Regional economies, on the other hand, have seen steady growth over the past two years. Specifically, Osaka, Aichi (Nagoya), and Fukuoka have seen respective increases of 0.31x, 0.21x, and 0.24x since March 2016. All three outpaced Tokyo, where the job-to-application ratio stayed high but grew only 0.06x over the same period and remained flat YoY.

Corporate profits have also soared over the past several years, growing nearly 70% from 2012 to 2017. As business improves, firms are expanding regional offices to accommodate increasing workforce by moving into new, prime locations or by expanding leased space in current offices. Strong corporate performance may also be giving landlords more confidence that they can successfully raise contract rates.

Outlook

High-grade buildings in Osaka, Nagoya, and Fukuoka continue to perform exceptionally well. Competition for talent combined with increasing profits has led major firms to relocate branch offices from aging company-owned structures and suburban locations to new, recognisable and centrally-located buildings on station-front property.

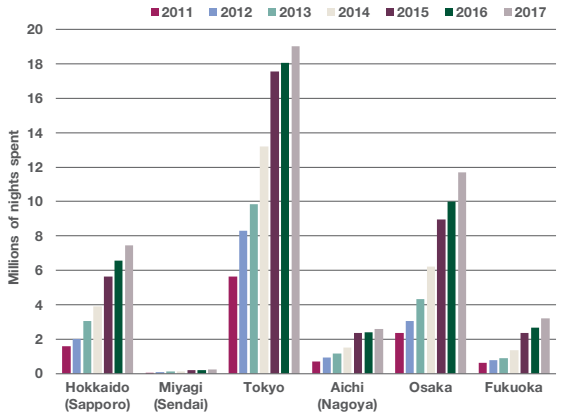
Despite this strong demand, lack of new supply in late 2017 and early 2018 has made relocation to quality assets exceedingly difficult. This should be having a positive impact on the all-grade market, as some firms may prioritise location over office grade.

Indeed, after several years of stagnation, average all-grade rents appear to be picking up across all major regional markets. Fukuoka and Sapporo have posted YoY rental gains across all surveyed submarkets, while the station-front markets in Sendai, Osaka and Nagoya have increased 1.1%, 2.1% and 4.0%, respectively.

To be sure, global economic uncertainty presents risks to the Japanese market. A potential trade war, political instability in Europe and geopolitical tensions in Asia could threaten Japan's economic prospects. Significant declines in overall corporate performance could also mean cutbacks in regional offices. However, steady migration to urban centres should help maintain demand fundamentals—putting upward pressure on land values in regional hubs—even as the broader market fluctuates.

GRAPH 4

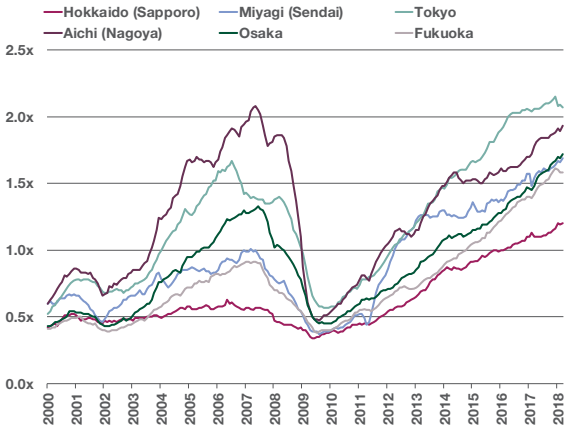
Nights spent by international visitors, 2011 – 2017(Est)



Source: Japan National Tourism Organization (JNTO), Savills Research & Consultancy

GRAPH 5

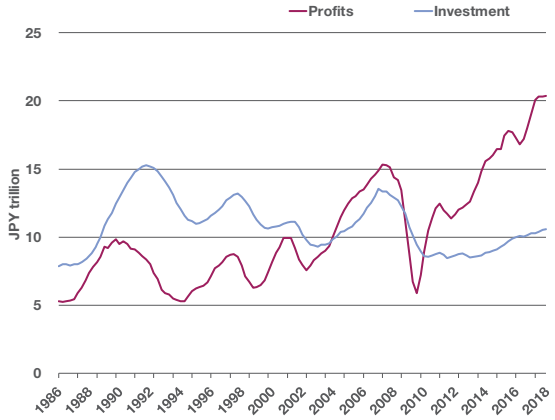
Job-to-application ratio, selected prefectures, 2000 – Apr 2018



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

GRAPH 6

Corporate profits and investment, 1986 – Q1/2018



Source: Ministry of Finance, Savills Research & Consultancy

Osaka

Osaka office market

Net Rentable Area (NRA)

Osaka's total NRA stood at 2.2 million tsubo as of May 2018. Major new projects in the pipeline include the Namba Skyo Building (formerly Shin-Nankai Kaikan) in September 2018, the Obic Midosuji Building in January 2020, as well as JP Tower Osaka and Osaka Umeda Twin Towers South in spring 2022.

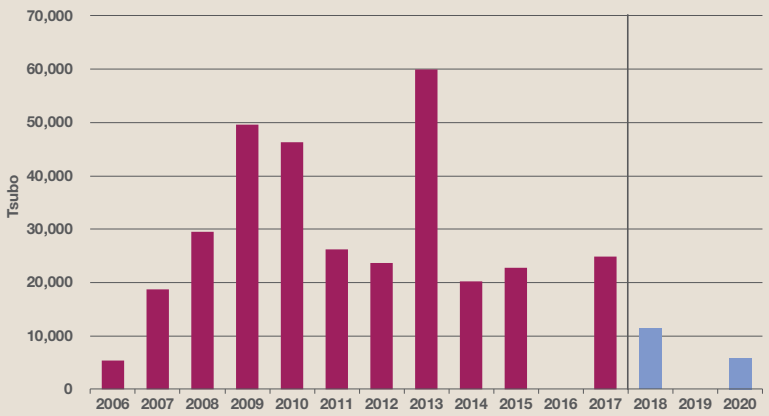
The Namba Skyo Building, which will introduce around 10,400 tsubo to the market, is said to be almost fully leased. WeWork is rumoured to have pre-leased a few office floors and other tenants mainly consist of regional banks and insurance companies. The Obic Midosuji Building, a 16,800 tsubo GFA hotel and office project, will provide around 5,900 tsubo of leasable office space over 11 floors. Looking further ahead, JP Tower Osaka is expected to be completed in early 2022 with a GFA of 41,000 tsubo for its office floors. Pre-leasing is also underway for Osaka Umeda Twin Towers South with asking rates rumoured to hover around the mid-to-high JPY30,000 range.

Vacancy

Average high-grade vacancy across all Osaka submarkets has tightened 1.1ppts YoY to sit at 0.7% as of May. The all-grade vacancy rate for surveyed districts stood at 3.4% in May 2018, down 0.9ppts from a year earlier. Semba recorded the largest YoY tightening of 1.4ppts, dropping to 5.5%. Shinsaibashi-Namba dropped 1.0ppts to 3.4% as of May. The Sakurabashi Miyuki Building, which was completed in Umeda in September of last year, is rumoured to be fully leased as of this report.

GRAPH 7

New NRA office supply in Osaka, 2006 – 2020



Source: Sanko Estate, Savills Research & Consultancy

Rent

Average high-grade office rents in Osaka have risen 11.9% YoY and now stand at JPY19,900 per tsubo per month. Shin-Osaka notably took the lead in average rental growth, with contract rates increasing by JPY2,600 per tsubo per month, or 16.4% YoY. It is rumoured that the asking rates for certain prime buildings in front of Osaka Station have returned to 2007 levels, but others appear to have room for further growth before reaching such levels.

All-grade rents in Osaka have been growing for 16 consecutive months, standing at JPY11,300 per tsubo as of May 2018, a 1.7% increase YoY. Semba has taken the lead in growth as of May, posting a 2.6% YoY gain, with Umeda and Yodoyabashi-Honmachi posting YoY gains of 2.0% and 1.5%, respectively. The Shinsaibashi-Namba market posted YoY growth for the first time since September 2008.

Umeda

High-grade rents in Umeda and Nakanoshima range from JPY20,000 to JPY32,000 per tsubo per month. Top rents are achieved by the Umeda

TABLE 4

Osaka prefecture key macro indicators*

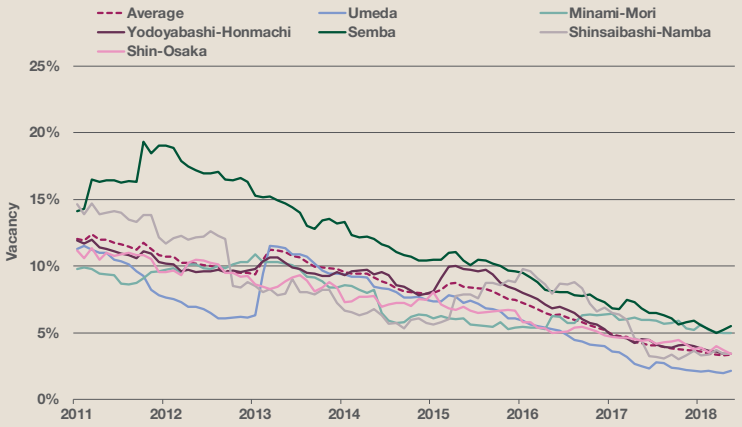
	Japan	Tokyo	Osaka
Real GDP (JPY trillion)	533.1	103.6	**38.6**
YoY%	1.1	1.7	**1.5**
% of Japan	100%	20%	**7%**
Population (thousands)	126,490	13,820	**8,826**
Job to applicant ratio	1.6	2.1	**1.7**

Source: Cabinet Office, Osaka Prefectural Government, Savills Research & Consultancy
* Real GDPs for Japan, Tokyo, and Osaka are for Q1/2018, Q1/2016, and Q1/2016 respectively.

Osaka (cont.)

GRAPH 8

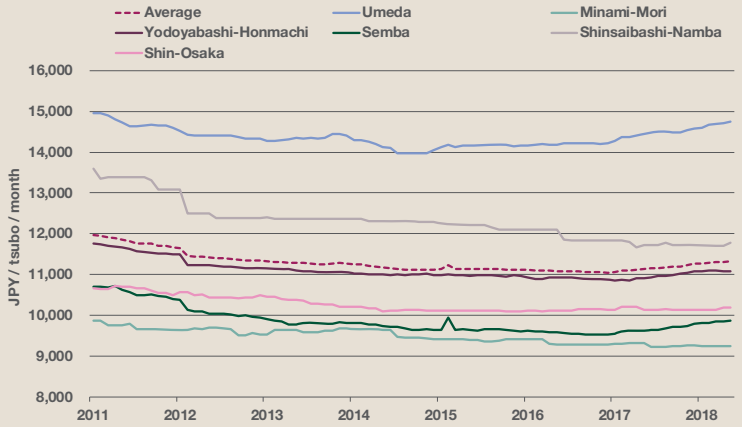
Vacancy rate in Osaka by area, 2011 – May 2018



Source: Miki Shoji, Savills Research & Consultancy

GRAPH 9

Average rent in Osaka by area, 2011 – May 2018



Source: Miki Shoji, Savills Research & Consultancy

TABLE 5

Osaka high-grade offices

	1H/2018	HoH	YoY
Rent	19,900	7.0%	11.9%
Vacancy	0.7%	-0.5ppts	-1.1ppts
Top rent	32,000+	0.0%	6.7%

Source: Savills Research & Consultancy

Hankyu Building, followed by the Yoshimoto Building and Grand Front Osaka Tower A.

Yodoyabashi-Honmachi
High-grade rents in Yodoyabashi and Honmachi range from JPY12,000 to JPY25,000 per tsubo per month. Vacancy in Yodoyabashi and Honmachi has rapidly improved since the loosening in 2015 caused by large tenants' relocations to newly-built corporate-owned office buildings. As of May, all-grade vacancy in the submarket stood at 3.4%, down 1.1ppts YoY.

Shin-Osaka
High-grade rents in Shin-Osaka range from JPY14,000 to JPY25,000 per tsubo per month. Asking rates have risen across the board as vacancy has contracted to under 0.1%.

All-grade vacancy also continues to tighten, dropping to 3.5% as of May. Not surprisingly, relocations in the area continue to be difficult.

Outlook
Both high-grade and all-grade rents are seeing increased upward momentum. With the Namba Skyo Project as the sole large-scale office project for 2018 and no major projects in the pipeline for 2019, demand for high-grade office space should continue to outpace supply. As inbound tourism continues to break records, ageing office buildings are generally being redeveloped as hotels, retail centres or apartment buildings.

For the past several years, it had been common for firms to sell suburban, company-owned office buildings and move into central Osaka; however, it appears that lack of availability has slowed this trend.

Exceptionally low vacancy in the high-grade market has led to a rapid increase in rent, particularly in Umeda and Shin-Osaka. Small to medium-sized buildings, on the other hand, still have some available space, offering more flexibility for prospective tenants. All-grade rents should continue to increase steadily as vacancy further contracts.

Nagoya

Nagoya office market

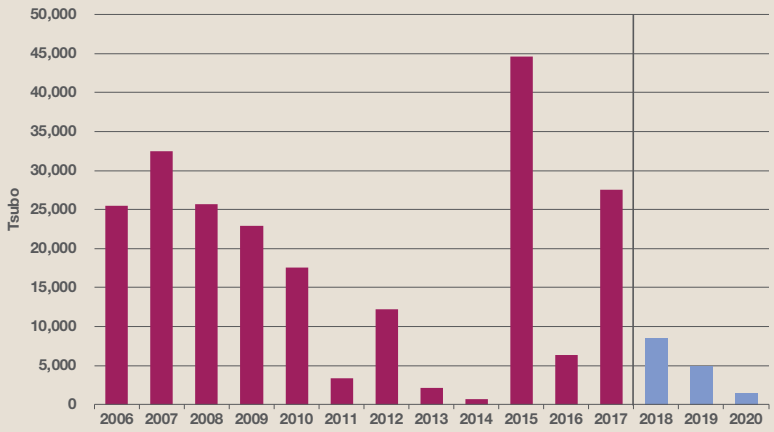
NRA

Total NRA in Nagoya stood at 1.0 million tsubo as of May 2018. After a jump in completions last year, marked by the opening of the JR Gate Tower and Global Gate Tower, supply is set to cool down greatly in 2018 and beyond.

Hirokoji Cross Tower (formerly the Nishiki 2-chome Project), the only major project slated for 2018, was completed in March. MUFG Bank is rumoured to occupy the entirety of the available office space as of this report. All available office space in the Yamaichi Building, slated for completion in January 2019, has already been leased to the Aichi Labour Bureau. Kajima Corporation has also broken ground on the tentatively named Kajima Fushimi Building, which is set for completion in September 2019, adding 3,200 tsubo to the market. It is rumoured that one third of the space has been pre-leased with asking rates around JPY20,000 per tsubo. In June, Mitsui Fudosan began construction of Nagoya Mitsui Building North, a project with a planned GFA of 8,900 tsubo set for completion in the Meieki area in early 2021. Further development will be limited until Meitetsu begins construction of a massive mixed-use redevelopment project in 2022.

GRAPH 10

New NRA office supply in Nagoya, 2006 – 2020



Source: Sanko Estate, Savills Research & Consultancy

Vacancy

High-grade vacancy across all Nagoya submarkets has tightened 2.0ppts YoY and 2.3ppts since October to sit at 0.4% as of May. All-grade vacancy has largely kept pace, tightening 2.5ppts YoY and 1.7ppts since October, sitting at 3.4% as of May. All surveyed submarkets posted declines of over 1.9ppts YoY and now sit at or below 3.8%.

Global Gate Tower West, which began operation with sizeable vacancy in early 2017 due to infrastructure woes, has seen a jump in leasing over the past half year. The building is said to be nearing full occupancy.

Relocations from the suburbs and ageing company-owned office buildings are driving demand. Competition has intensified to the point where tenants must submit applications immediately after viewing a property. Landlords are increasingly conducting direct sales activities without utilising brokers.

Rent

Average high-grade office rents in Nagoya have risen 8.7% YoY and now stand at JPY18,100 per tsubo per month. This was mainly driven by Meieki, which has seen average rents increase by JPY2,900, or 12.3% YoY.

TABLE 6

Aichi prefecture key macro indicators*

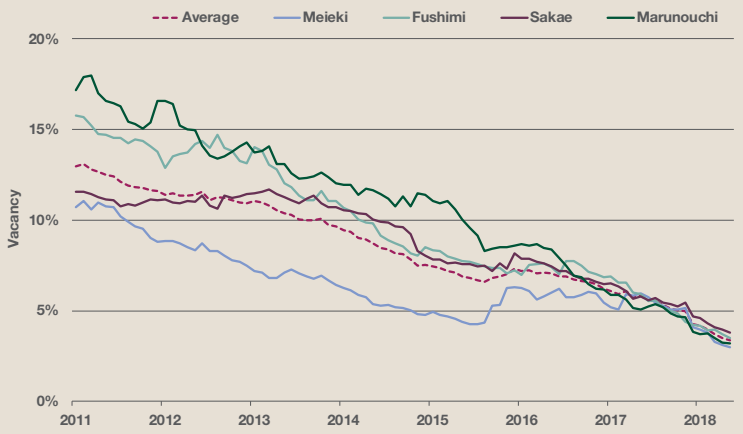
	Japan	Tokyo	Aichi
Real GDP (JPY trillion)	533.1	103.6	**37.4**
YoY%	1.1	1.7	**0.7**
% of Japan	100%	20%	**7%**
Population (thousands)	126,490	13,820	**7,553**
Job to applicant ratio	1.6	2.1	**1.9**

Source: Cabinet Office, Aichi Prefectural Government, Savills Research & Consultancy
* Real GDPs for Japan, Tokyo, and Aichi are for Q1/2018, Q1/2016, and Q1/2016 respectively.

Nagoya (cont.)

GRAPH 11

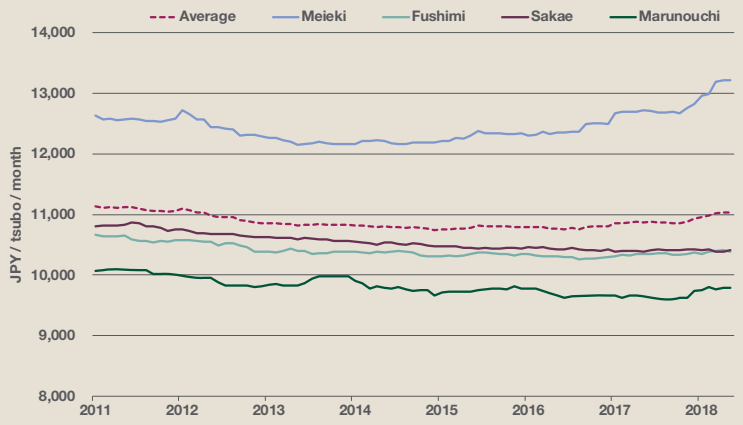
Vacancy rate in Nagoya by area, 2011 – May 2018



Source: Miki Shoji, Savills Research & Consultancy

GRAPH 12

Average rent in Nagoya by area, 2011 – May 2018



Source: Miki Shoji, Savills Research & Consultancy

TABLE 7

Nagoya high-grade offices

	1H/2018	HoH	YoY
Rent	18,100	7.6%	8.7%
Vacancy	0.4%	-2.3ppts	-2.0ppts
Top rent	35,000+	16.7%	16.7%

Source: Savills Research & Consultancy

All other submarkets have also seen YoY gains in high grade rents, with Fushimi and Sakae rates each increasing by 4.7% while Marunouchi posted a gain of 3.3%.

Average all-grade office rent in Nagoya as of May 2018 was JPY11,000 per tsubo, an increase of 1.4% YoY and 1.6% since October. Though the Meieki submarket has clearly pulled ahead with 3.9% YoY growth, the Marunouchi submarket has also turned upward, growing 1.5% YoY, while the Fushimi market posted a modest 0.3% gain.

Meieki

Asking rates for station-side tower locations now range from JPY32,000 to JPY36,000, while large-scale office space in the area is coming in at JPY20,000 to JPY25,000 per tsubo per month. Top rates in the area have soared, led by JR Central Towers, JR Gate Tower, and JP Tower Nagoya. In January, Towa Fudosan acquired Yanagibashi Foods Building Co., which owns multiple buildings in the Midland Square Area. Towa intends to partner with nearby landowners to redevelop the area.

Fushimi and Marunouchi

High-grade rents in Fushimi and Marunouchi now range from JPY14,000 to JPY17,000 per tsubo per month. While top rents in the area remain unchanged, rates have increased for older buildings at the bottom of the range.

Outlook

Large firms continue to sweep up premium space in an ever-tightening market. Both high-grade and all-grade rents, particularly in the Meieki area, have seen a substantial uptick over the past half-year. Even as Meieki leads the market, rents in surrounding areas are also picking up as available space contracts across all submarkets and office grades.

Limited supply in the near-term should continue to intensify competition for space in prime station-side locations, while the surrounding submarkets stand to gain from overall urbanisation and further concentration of corporate offices in the central districts of Nagoya.

Fukuoka

Fukuoka office market

NRA

Total office NRA currently sits around 0.7 million tsubo. Major completions in early 2018 include the JS Hakata Watanabe Building with a GFA of 1,900 tsubo and the Kamiyo Hakata Chuo Building with a GFA of 5,700 tsubo, both of which appear to be fully leased. While some smaller projects are slated for early 2019, no major developments will be completed until the Tenjin Business Center Project comes online in early 2021.

In March, it was announced that Nishi-Nippon Railroad and Sekisui House have been granted the right of first refusal for the redevelopment of the former Daimyo Elementary School Site on the western end of the Tenjin Big Bang initiative. Development of the 24,000 tsubo site is scheduled for completion by the end of 2022, with certain portions opening in 2021, and will contain public and private spaces including a combined office and hotel (Ritz-Carlton) building, adding over 8,000 tsubo of office NRA to the market.

Select areas in Fukuoka are also seeing a loosening of height restrictions, which will increase the scale of some upcoming projects.

Vacancy

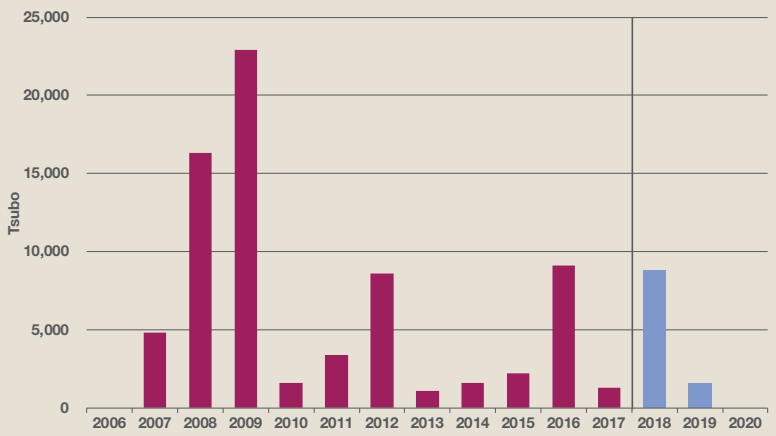
High-grade vacancy in Fukuoka has tightened 0.1ppts YoY and sits at 0.3%, remaining the tightest high-grade office market surveyed in this report.

Fukuoka's average all-grade vacancy rate has fallen to 2.9% as of May 2018, with all surveyed submarkets now sitting at or below 3.5%.

Despite such tight conditions, landlords do not appear to be implementing bidding systems or sharp increases in contract rates. Interestingly, newspaper companies that own and occupy buildings in prime locations are taking advantage of this tight market, leasing underutilised sections of their once exclusive space to generate additional revenue.

GRAPH 13

New NRA office supply in Fukuoka, 2006 – 2020



Source: Sanko Estate, Savills Research & Consultancy

Rent

High-grade office rents in Fukuoka continue to drive upwards on the back of airtight vacancy, increasing 12.4% YoY to stand at JPY16,900 per tsubo per month.

Rent growth in the all-grade market has also picked up pace significantly, with the average for the city increasing 3.7% YoY to land at JPY9,700 per tsubo per month. This is the largest YoY increase ever recorded by Miki Shoji. All surveyed submarkets in the city have posted increases of at least 2.3%.

Station Front

High-grade rent around Hakata Station now ranges from JPY17,000 to

TABLE 8

Fukuoka prefecture key macro indicators*

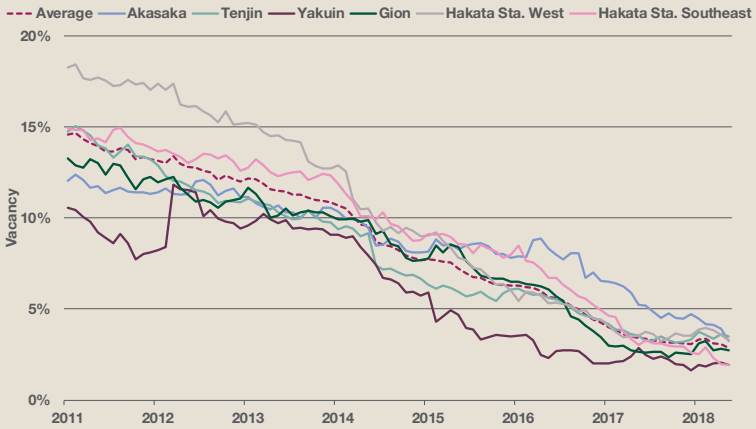
	Japan	Tokyo	Fukuoka
Real GDP (JPY trillion)	533.1	103.6	**18.2**
YoY%	1.1	1.7	**2.1**
% of Japan	100%	20%	**3%**
Population (thousands)	126,490	13,820	**5,110**
Job to applicant ratio	1.6	2.1	**1.6**

Source: Cabinet Office, Osaka Prefectural Government, Savills Research & Consultancy
* Real GDPs for Japan, Tokyo, and Fukuoka are for Q1/2018, Q1/2016, and Q1/2016 respectively.

Fukuoka (cont.)

GRAPH 14

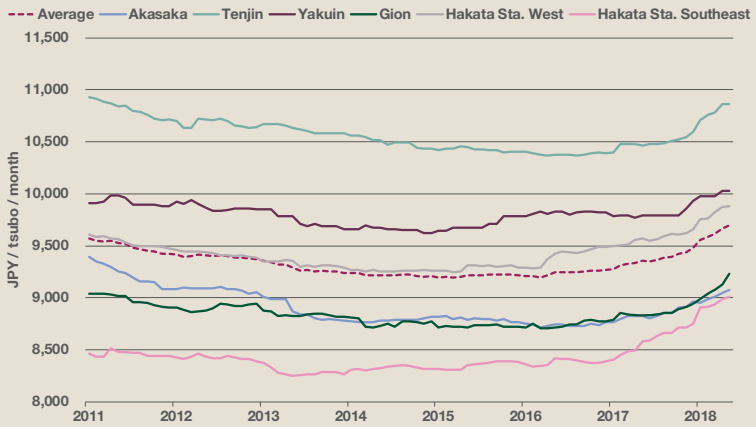
Vacancy rate in Fukuoka by area, 2011 – May 2018



Source: Miki Shoji, Savills Research & Consultancy

GRAPH 15

Average rent in Fukuoka by area, 2011 – May 2018



Source: Miki Shoji, Savills Research & Consultancy

TABLE 9

Fukuoka high-grade offices

	1H/2018	HoH	YoY
Rent	16,600	4.6%	12.4%
Vacancy	0.3%	0.0ppts	-0.1ppts
Top rent	23,000+	15.0%	15.0%

Source: Savills Research & Consultancy

JPY23,000 per tsubo per month. Top rents in the area are achieved by the JRJP Hakata Building.

As the Kamiyo Hakata Chuo Building was fully leased upon opening, available high-grade office space around the station remains almost non-existent.

Tenjin

High-grade rent in the Tenjin area now generally ranges from JPY13,000 to JPY20,000 per tsubo per month, though top asking rates can reach JPY23,000. This is still well below the 2007 high of around JPY28,000 per tsubo, indicating that rents in the area still have some room to grow.

With the loosening of building height restrictions in the area, it was announced that the Tenjin Business Center Project will add three additional floors. It has also been rumoured that the first four floors of the building will be leased by a bank.

Outlook

Fukuoka remains Japan's fastest growing regional city. The local government has undertaken unique measures to attract businesses, support startups and ease visa restrictions for foreign entrepreneurs. Convenient access to East Asian hubs also makes the area attractive to foreign firms and workforce.

Airtight vacancy rates have driven all-grade rental growth to record highs. Though the rate of growth may cool down somewhat moving forward, rents are likely to increase until redevelopments related to the Tenjin Big Bang initiative begin coming online in 2021.

Indeed, with positive demographic and economic prospects, Fukuoka's office demand fundamentals are strong. As the city continues to attract domestic and international interest, we can expect the office market to perform well in the near term.

Sendai

Sendai office market

NRA

As of May 2018, Sendai's office market totalled 0.5 million tsubo. Since the Great East Japan Earthquake there has been limited new construction and, as a result, this has put pressure on vacancy rates and rents.

With the completion of Nomura Real Estate's Aoba-dori building in April 2017, no upcoming large-scale office development projects have been announced. However, in March 2018, Nomura Real Estate notably purchased the former Tohoku Regional Development Bureau. According to the Nikkei, it is likely that this 1,500 tsubo site will be developed into an office building, though the details of the project have not yet been released.

The Sendai Chuo Building is also expected to be redeveloped into a new office building, with plans to add office space by expanding the current building's 2,700 tsubo GFA.

Vacancy

Sendai's average all-grade vacancy rate sits at 6.2% as of May 2018, a tightening of 1.9ppts YoY. The Station Front submarket has the tightest vacancy rate at 5.2% with the 1-bancho submarket close behind at 5.4%. The Station East submarket has a relatively high vacancy rate of 7.9%; however, it has seen the greatest fall in vacancy YoY, dropping 3.4ppts.

Rent

Average all-grade rents in Sendai stood at JPY9,000 per tsubo per month in May 2018, edging up 0.5% YoY. This slow upward trend has been visible since June 2017, encouraged by falling vacancy rates. It marks a positive break for the city which has generally seen negative YoY growth in rents since the March 2011 disaster. All but one submarket have seen YoY rent increases, although growth is driven primarily by the Station Front submarket where rent is up by 1.1% YoY. If vacancy continues to tighten, the city could continue to see additional increases going forward.

Outlook

Average rent in Sendai has grown moderately over the past year as average vacancy continues its seven-year downward trend. While there is clear demand for office space in the area, most landlords still appear hesitant to raise contract rates. Looking ahead, planned office developments are scarce but some buildings in Sendai that were destroyed in the Great East Japan Earthquake have potential for redevelopment. Upcoming residential developments in central Sendai and along nearby commuter hubs are also an encouraging sign of developer interest in the area.

Overall urbanisation trends should increase demand for commercial office space in the area. With demand driven primarily by the IT sector, including software companies such as IBM, CData Software Japan and Amazon, moderate growth in rents and tightening of vacancy rates could be set to continue. Also, relatively high vacancy rates compared to the other major regional cities surveyed and limited upcoming supply in those areas may actually prove to be a boon for Sendai. Expanding firms that are having difficulty obtaining office space, such as space for call centres, in other major markets may now turn to the area instead.

Damage from the March 2011 disaster hampered the city's growth; however, after a drawn-out recovery, Sendai may be ready to reassert itself.

TABLE 10

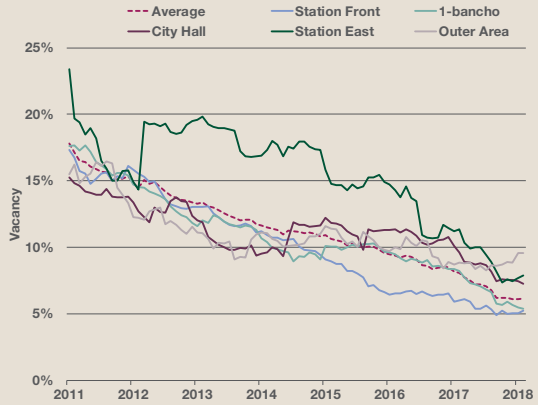
Miyagi prefecture key macro indicators*

	Japan	Tokyo	Miyagi
Real GDP (JPY trillion)	533.1	103.6	**9.2**
YoY%	1.1	1.7	**0.9**
% of Japan	100%	20%	**2%**
Population (thousands)	126,490	13,820	**2,316**
Job to applicant ratio	1.6	2.1	**1.7**

Source: Cabinet Office, Miyagi Prefectural Government, Savills Research & Consultancy
* Real GDPs for Japan, Tokyo, and Miyagi are for Q1/2018, Q1/2016, and Q1/2017 respectively.

GRAPH 16

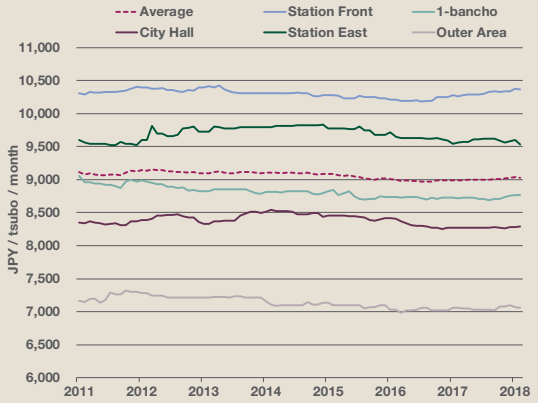
Vacancy rate in Sendai by area, 2011 – May 2018



Source: Miki Shoji, Savills Research & Consultancy

GRAPH 17

Average rent in Sendai by area, 2011 – May 2018



Source: Miki Shoji, Savills Research & Consultancy

Sapporo

Sapporo office market

NRA

Sapporo's total office NRA is approximately 0.5 million tsubo. There have been several new developments, resulting in increasing rents.

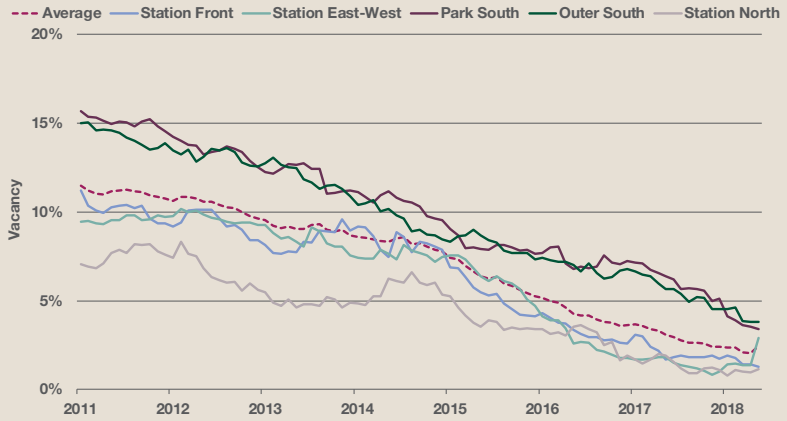
Several developments due to complete in the coming years are in the Station East-West and Park South submarkets. The completion of Sapporo Sousei Square in May 2018, a mixed-use structure with a GFA of 40,000 tsubo, added an additional 7,500 tsubo of leasable office space to the market. Looking ahead, only three notable office development projects remain in the pipeline through 2020.

2019 will see the completion of two small-scale projects including the tentatively named Minami Odori Building North Ichijo and the S1E3 Building, which have a combined GFA of around 4,000 tsubo.

2020 is expected to see a larger amount of supply added with the redevelopment of the Daido Life Sapporo Building. The development will cover an area including the current structure as well as a neighbouring building, creating a combined B1/14F structure with 7,300 tsubo of GFA. The basement level of the new structure will integrate with the underground passage that connects JR Sapporo

GRAPH 18

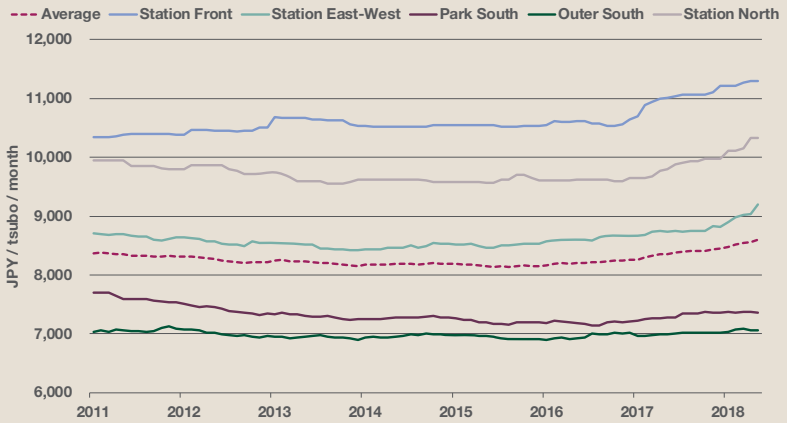
Vacancy rate in Sapporo by area, 2011 – May 2018



Source: Miki Shoji, Savills Research & Consultancy

GRAPH 19

Average rent in Sapporo by area, 2011 – May 2018



Source: Miki Shoji, Savills Research & Consultancy

TABLE 11

Hokkaido prefecture key macro indicators*

	Japan	Tokyo	Hokkaido
Real GDP (JPY trillion)	533.1	103.6	**18.3**
YoY%	1.1	1.7	**1.1**
% of Japan	100%	20%	**3%**
Population (thousands)	126,490	13,820	**5,318**
Job to applicant ratio	1.6	2.1	**1.2**

Source: Cabinet Office, Hokkaido Prefectural Government, Savills Research & Consultancy
* Real GDPs for Japan, Tokyo, and Hokkaido are for Q1/2018, Q1/2016, and Q1/2016 respectively.

Sapporo (cont.)

Station with the Sapporo Subway Station, increasing the area's connectivity.

Vacancy
The average vacancy rate for Sapporo as of May 2018 is 2.4%. Vacancy is particularly tight around the station, tightening to less than 1.3% in two of three station submarkets. With the addition of Sapporo Sousei Square in May, average vacancy in the Station East-West market has risen 1.5ppts since April. Miki Shoji data suggests that the building came online with the majority of its space leased.

The largest YoY tightening in vacancy rates occurred in the Park South submarket, which fell 3.0ppts, primarily driven by demand from IT companies.

Rent
As of May 2018, the average YoY growth in office rents is 2.9%, which is higher than all other regional submarkets except for Fukuoka. The average rent now stands at JPY8,600 per tsubo, although there are large differences between the submarkets, with the station submarkets achieving up to JPY4,000 per tsubo more than the average rent in the Park South and Outer South areas. Encouraged by low vacancy and lack of supply, rental growth has been particularly strong in the Station North area at 5.5% YoY. On the other hand, the addition of Sapporo Sousei Square appears to have bolstered YoY rental growth in the Station East-West submarket to 5.3% as of May.

Outlook
As Sapporo continues to see a record number of inbound tourists, investment activity is unsurprisingly focused around the hospitality and retail sectors. Against this backdrop, lack of office development has made vacancy ultra-tight even while strong demand for additional space persists.

This pressure appears to have finally given way to increasing rents as positive YoY rental growth was recorded across all submarkets, though growth was far more pronounced in the station-side markets.

The suburban population continues to migrate to areas with convenient access to the central station. With a stable workforce attracting companies such as AXA Life Japan, Amazon and IBM, and relatively limited new supply on the horizon, the market is likely to strengthen with increasing rents and tightening vacancy rates set to continue.

Please contact us for further information

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