Spotlight
Regional Japanese office markets

November 2018

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"Rental growth in regional office markets is strong as limited supply keeps vacancy rates tight and landlords are becoming more aggressive in negotiation. Rents are likely to continue to increase, but growth may slow as extremely low availability is limiting relocations."

High-grade offices[1]

Regional high-grade office markets continue to perform well. Vacancy is steadily declining as expanding demand soaks up existing stock and new supply is relatively limited. High-grade office rental growth is in the double-digits.

High-grade vacancy remains below 1% in the three major regional markets. Although Fukuoka vacancy rose slightly year-on-year (YoY), the average level is still extremely low at 0.4%. Osaka and Nagoya continue to tighten, with Nagoya performing particularly well, down 1.3 ppts YoY to sit at just 0.2% vacancy.

High-grade rental growth across the three major regional markets reflects tight vacancy, averaging over 10% YoY (Table 1). Growth rates appear to be cooling slightly in Fukuoka but accelerating in Nagoya and, to a lesser extent, Osaka.

All-grade offices[2]

All-grade market performance is also strong, illustrating that office demand is strengthening in overall markets. While station-front submarkets continue to lead growth in most cities, market indices are improving in surrounding submarkets as well.

Average vacancy has now dipped below 3% in most all-grade markets save Sendai. Vacancy in Sendai is falling particularly quickly, however. The tightest vacancy in Q3 was recorded by Station North in Sapporo at 0.5%. Urbanisation and tourism stimulus measures appear to be working to the benefit of Japan's regional cities.

Reinforced by tightening market conditions, all-grade rents are also growing steadily, though not as rapidly as high-grade. Fukuoka and Sapporo saw the highest percentage gains YoY, at 5.1% and 3.2%, respectively, while Osaka and Nagoya grew at around 2% YoY (Table 2).

While high-grade offices are still outperforming overall office markets, extremely low vacancy rates in high-grade realms appear to be translating into a tightening of vacancy and a strengthening of rents in all-grade markets.

Especially in Fukuoka and Osaka, floors in retail buildings are being converted to office spaces to accommodate pent-up demand.

Additionally, WeWork has turned its gaze to regional markets and has recently announced its plan to start operation in cities such as Yokohama, Osaka, and Fukuoka. Eager to expand, the company may try to snatch up any large spaces that become available under such tight conditions.

The latest semi-annual survey by the Japan Real Estate Institute (JREI) shows that regional cap rates continue to compress even as Tokyo rates have paused. Regional cities are still showing yield gaps of 1.0 to 2.0 ppts over Tokyo, with Sendai and Sapporo offering the greatest spread.

Year-to-date transaction volumes through September are at JPY2.4 trillion, less than half of the 2017 total. A reduction in transaction volumes is largely attributable to limited acquisition opportunities. Offices in regional cities, especially Osaka, see sound investment interest from overseas.

In August, Blackstone Group acquired the Edobori Center Building for a rumoured JPY15 billion. In the same month, MCUBS MidCity announced the sale of the MID REIT Kyobashi Building to Morgan Stanley for JPY1.7 billion. Additionally,

TABLE 1

High-grade office performance, 2H/2018

	Vacancy	YoY ppts	Rent	YoY
Osaka	0.8%	-0.3	20,700	11.3%
Nagoya	0.2%	-1.3	18,700	10.7%
Fukuoka	0.4%	0.1	17,300	8.7%

Source: Savills Research & Consultancy

TABLE 2

All-grade office performance, 2H/2018

	Vacancy	YoY ppts	Rent	YoY
Osaka	2.9%	-0.9	11,400	1.9%
Nagoya	2.9%	-2.2	11,100	2.0%
Fukuoka	2.5%	-0.7	9,900	5.1%

Source: Miki Shoji, 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.

LaSalle Investment Management announced its acquisition of Midosuji Front Tower, which has remained vacant since its completion in 2010, and CBRE GI acquired the Kitahama Nexus Building for an estimated JPY20 billion in October. As market fundamentals are strengthening in regional cities, more investors may eye opportunities outside of Tokyo seeking better yields.

The July land value survey (Kijun Chika) produced by the Ministry of Land, Infrastructure, Transport and Tourism (MLIT) confirmed January's results: commercial land prices are rising nationwide. Furthermore, all regions registered stronger YoY growth rates than in 2017, exhibiting strong upwards momentum. In particular, all regions covered in this report except Hokkaido came at the top of the growth rankings. Hokkaido has lagged other regions in the past but moved into YoY growth for the first time in at least nine years.

Demand for regional commercial land is rising as local corporations recognise the growth opportunities of regional tourism, a key component of the government's agenda. Prices in central districts are growing the fastest as such prime locations are experiencing the strongest demand.

Regional macro

Regional economies appear solid with a stable, promising outlook. Improving economic conditions and government stimulus measures are feeding consumer and business confidence in a virtuous cycle.

The Bank of Japan (BOJ) confirmed in its October Regional Economic Assessment that all regional economies are either expanding or recovering (Table 3). In particular, business fixed investment is strong across the board, which could be indicative of plans for business expansion. Additionally, small- and medium-sized companies* have been steadily improving profits. Considering that those companies employ a majority of workers in regional cities, overall improvement in their performance bodes well for local economies.

Employment and demand

Off the back of economic improvements, the national unemployment rate has fallen to 2.3% and the job-to-application ratio reached 1.64x in September. While the ratio remains the highest in Tokyo at 2.18x, ratio growth has recently been faster in most regions. While increases have become somewhat moderate in Tokyo since 2016, Osaka and Nagoya particularly saw growing needs for labour in recent years.

Signs of strong labour demand from corporations and a tight supply-demand balance might convince landlords it is safe to raise contract rents when it comes time to renew, particularly in all-grade, where rents have space to catch up to

TABLE 3

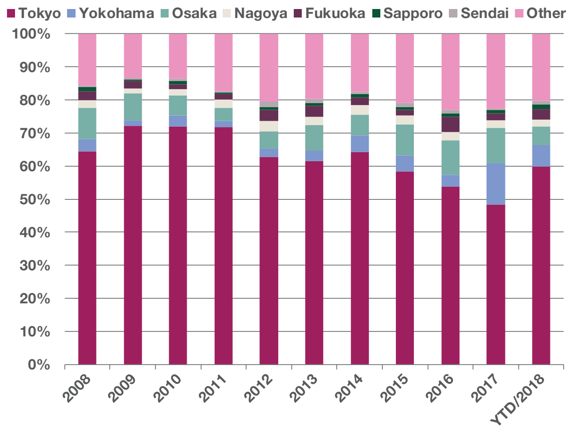
BOJ regional economic assessment, Oct 2018

Region	Trend	Change vs January
Hokkaido (Sapporo)	"Has been recovering moderately, with earthquake induced downward pressure"	
Tohoku (Sendai)	"Has continued to recover moderately"	
Kanto (Tokyo)	"Expanding moderately"	
Tokai (Nagoya)	"Expanding"	
Kinki (Osaka)	"Has been recovering moderately, though Typhoon No. 21 effects observed"	
Kyushu (Fukuoka)	"Expanding moderately, with growth gaining more solid footing"	

Source: Bank of Japan, Savills Research & Consultancy

GRAPH 1

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

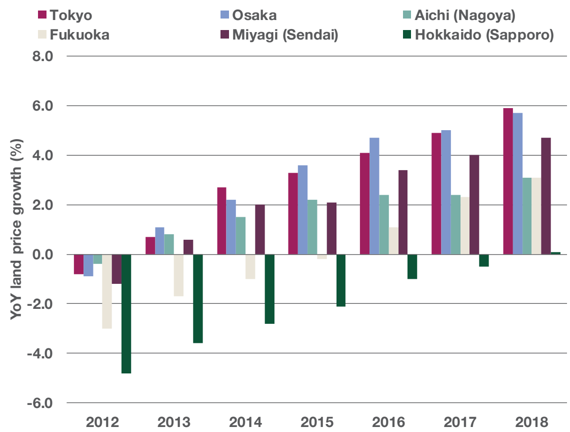


Source: RCA, Savills Research & Consultancy

* Transactions where specific locations have not been identified are classified as other.

GRAPH 2

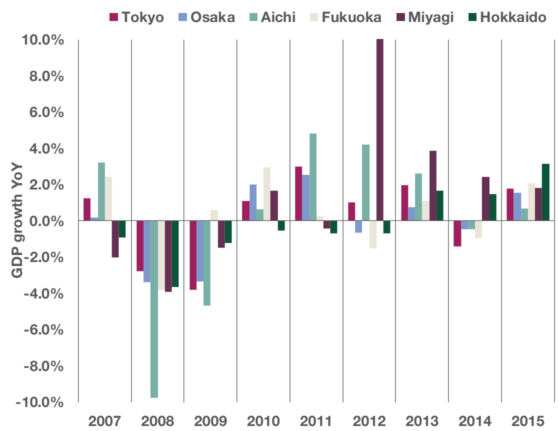
Kijun Chika commercial land prices



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

GRAPH 3

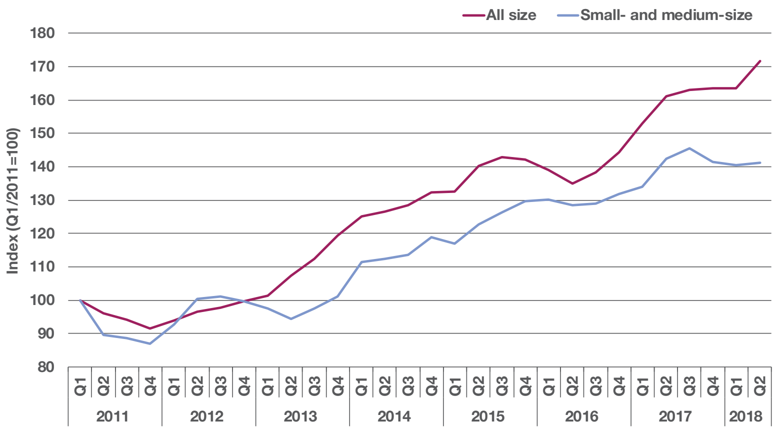
Regional GDP growth FY2007 – FY2015



Source: Prefectural governments, Savills Research & Consultancy

GRAPH 4

Profits of small- and medium-sized and all-sized companies, Q1/2011 – Q2/2018



Source: Ministry of Finance, Savills Research & Consultancy
* Small- and medium-sized companies are defined as those with capital stock of less than JPY100 million.

high-grade. However, a persistent shortage of labour could stifle local economies. According to Teikoku Data Bank, the number of bankruptcies primarily caused by problems related to labour shortages has been increasing since 2013. With declines in population increasingly weighing on regional cities, improvement in productivity is essential.

Osaka in focus

The Osaka office market was severely affected by the financial crisis since rapid demand declines coincided with a surge of supply pumped by the fund bubble. However, Umeda started to experience steady rental increases in 2015. Lagging a little over 20 months, the average rent in the overall Osaka market finally began a steady recovery in 2017.

Graph 6 illustrates that large-scale office rent growth in recent years is stronger than in 2008, resulting from extremely tight market conditions. A common measure of tightness of a market is the vacancy rate, which has been lower than pre-crisis levels in Osaka in recent months. However, the current tightness of the market becomes even more apparent when looking at how little office space is even listed. Listed space is necessarily larger than physical vacancy, on which vacancy rates are based, since it also includes “latent vacancy” such as existing floors scheduled to be vacant and offices under construction. In September, merely 30,000 tsubo was listed compared to the pre-crisis low of 84,000 tsubo.

In addition to robust fundamentals, a string of business and sporting events may act as catalysts and further raise Osaka’s popularity. Development works at the Umekita second phase project due to complete in 2024 will significantly improve the area’s landscape and city function. Additionally, it seems increasingly likely that Osaka will obtain the right to host Integrated Resorts, potentially providing a massive boost to the economy over the long term. Osaka’s tourism could be also fuelled by the 2019 Rugby World Cup and the 2020 Tokyo Olympics. Osaka is also a strong candidate to host the World Expo 2025.

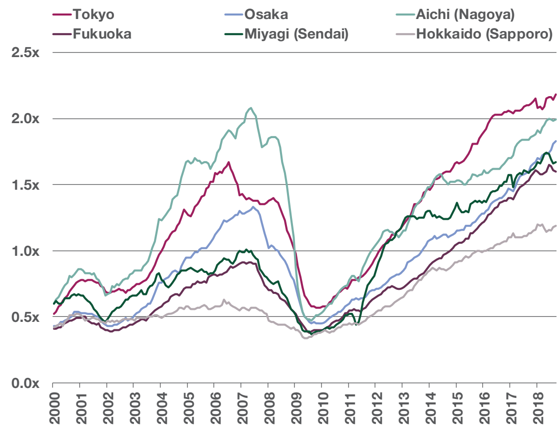
Outlook

High-grade offices, particularly those in prime locations, continue to do well, as demand is strong and is outpacing limited new supply. Long-term drivers of demand growth, such as net migration to urban centres and government efforts to stimulate regional economies, should continue to support regional office demand. As vacancy is extremely low in high-grade markets, turnover may decrease and cause rental growth to slow down somewhat. All-grade markets might also benefit by absorbing some unaccommodated demand. Medium-term prospects for both high- and all-grade regional office markets are favourable.

Regional markets have historically been more negatively affected during economic slowdowns, as national corporations closed branch offices and consolidated. Should preventative measures fail to insulate the negative effects of the consumption tax hike, or unexpected shocks to the economy materialise, companies may withdraw some demand from regional markets. Considering very limited supply in the near-term in all the studied regional markets, however, the impact of a contraction is unlikely to be severe.

GRAPH 5

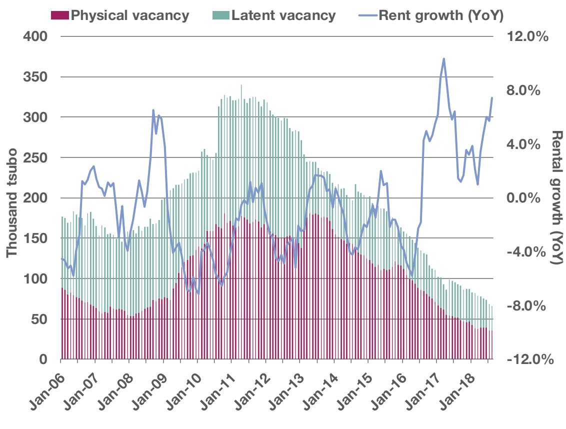
Job-to-application ratio, selected prefectures, 2000 – Sep 2018



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

GRAPH 6

Physical and latent vacancy vs rental growth in Osaka, 2006 – Aug 2018



Source: Sanko Estate, Savills Research & Consultancy

Osaka

Osaka office market

Net Rentable Area (NRA)

Osaka's total NRA has hovered around 2.2 million tsubo since 2016. New supply in the near term is also limited: there have been no large-scale office developments announced since the last report. The large-scale pipeline thus remains as: the newly-opened Namba Skyo Building with 10,400 tsubo NRA, Obic Midosuji Building, which will provide office NRA of 5,900 tsubo in 2020, and JP Tower Osaka with an office GFA of 41,000 tsubo in 2022. Umeda Twin Towers South is slated to complete in 2022.

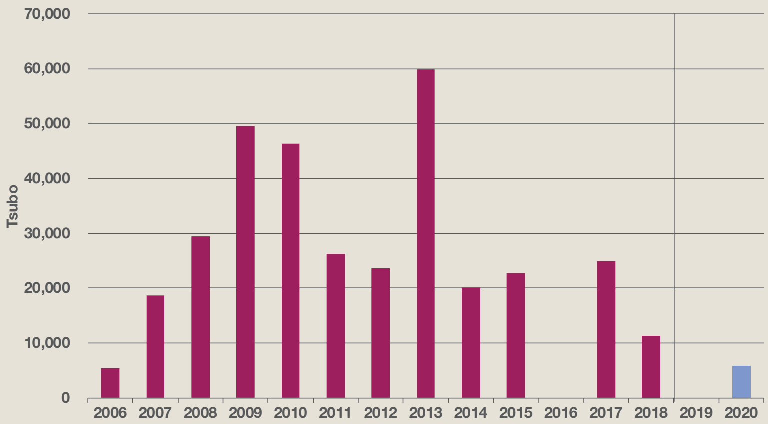
Looking beyond large-scale developments, there are a few smaller projects underway. NTT West expects completion of their 4,700 tsubo GFA Shin-Nihonbashi Building in early 2019. In October, LaSalle acquired Midosuji Front Tower, a 5,500 tsubo GFA office which has remained empty since completion in 2010 due to ongoing disagreements between the joint owners. LaSalle intends to attract tenants after renovating the office block.

Vacancy

Average high-grade vacancy is 8bps wider HoH, but 0.3ppts tighter YoY. The average high-grade vacancy rate at the end of September was 0.8%.

GRAPH 7

New NRA office supply in Osaka, 2006 – 2020



Source: Sanko Estate, Savills Research & Consultancy

The all-grade vacancy rate for surveyed districts stood at 2.9% in September 2018, down 0.9ppts YoY. Semba recorded the largest tightening, down 1.6ppts YoY to 4.5%. Shinsaibashi-Namba was the only submarket to register higher vacancy, up 1.4ppts YoY, due to the opening of the Namba Skyo Building. All submarkets save Minami-Mori registered less than 5% vacancy as of September.

Upcoming projects are being met with strong pre-leasing demand. For example, WeWork is confirmed to take three floors at Namba Skyo, or about one sixth of the entire building, with capacity for about 1,400 desks. Umeda Twin Towers South is also seeing interest despite completion being four years from now.

Rent

Average high-grade office rents in Osaka have risen 11.3% YoY to stand at JPY20,700 per tsubo per month at the end of September. Shin-Osaka continues to see strong rental growth, up 14.6% YoY, but was surpassed by Namba, which has managed to grow 14.7% YoY. Honmachi has lagged behind other submarkets over the last year, reporting growth of 6.7%, around half the Osaka average.

All-grade rents in Osaka stand at JPY11,400 per tsubo as of September,

TABLE 4

Osaka prefecture key macro indicators*

	Japan	Tokyo	Osaka
Real GDP (JPY trillion)	537.6	103.6	**38.6**
Real GDP (YoY%)	1.3	1.8	**1.5**
% of Japan (2015)	100%	20%	**7%**
Population (million)	126.4	13.8	**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 Q2/2018, for Tokyo, Osaka and % of Japan, 2015.

Osaka (cont.)

representing growth of 1.9% YoY. The pace of YoY growth has averaged 1.8% across each monthly observation in 2018. Semba and Umeda retain their positions at the top of the rent growth table throughout 2018 and continue to jostle for the number one spot. Shinsaibashi-Namba, which has generally languished since 2009, pushed into positive territory in Q2/2018 and has so far maintained this momentum.

Umeda

High-grade rents in Umeda and Nakanoshima range from JPY20,000 to over JPY35,000 per tsubo per month. Umeda Twin Towers South, due to complete in 2022, is rumoured to be asking for a higher amount, but top rents for current stock are gradually catching up to this level. A greater number of locations have been able to achieve the top level of rent, and growth has been broad-based rather than in a few buildings.

Yodoyabashi-Honmachi

High-grade rents in Yodoyabashi and Honmachi range from JPY12,000 to JPY25,000 per tsubo per month. Rents have risen at the lower end of the range, but the top end has remained steady. As of September, all-grade vacancy in the submarket stood at 2.7%, down 1.2ppts YoY. Despite boasting vacancy lower than the Osaka average, all-grade rental growth at 1.4% YoY trails behind that of Umeda and Semba.

Shin-Osaka

High-grade rents in Shin-Osaka range from JPY14,000 to JPY25,000 per tsubo per month. Top rents have not risen since the last report but average rents continue to grow, up 14.6% YoY. All-grade vacancy, at 3.6%, is tight enough to help stoke rental growth at a respectable 1.2% YoY, but growth lags behind the rapid growth rate of the high-grade market.

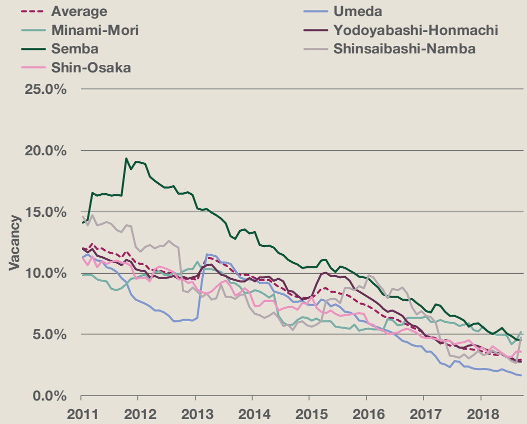
Outlook

Osaka has seen corporate profitability improve and has become a strong regional centre since performing poorly around the time of the financial crisis: Osaka's GDP growth in 2015 was above the national average, and high-grade rents are now growing at over 10% YoY. Strong pre-leasing demand for upcoming completions reinforces the perception of strong demand and a lack of supply.

Furthermore, there are many catalysts for growing the local economy on the horizon including the 2019 Rugby World Cup, the 2020 Tokyo Olympics, and the World Expo 2025, if awarded to Osaka. A potential IR location in the city could provide a massive boost as well. Both the high-grade and all-grade markets enjoy a bright outlook, with transport infrastructure improvements likely to feed demand and rents in the mid- to long-term, though growth rates may cool somewhat as a consequence of lower turnover from tight vacancy.

GRAPH 8

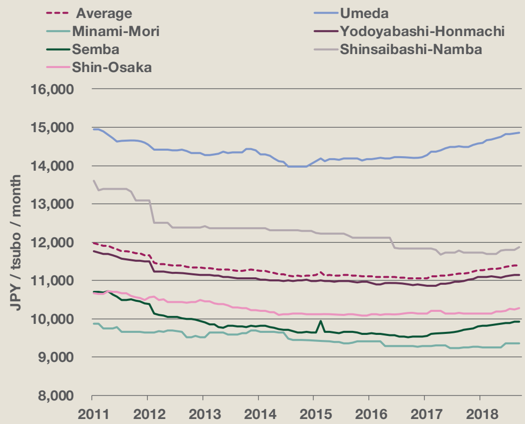
Vacancy rate in Osaka by area, 2011 – Sep 2018



Source: Miki Shoji, Savills Research & Consultancy

GRAPH 9

Average rent in Osaka by area, 2011 – Sep 2018



Source: Miki Shoji, Savills Research & Consultancy

TABLE 5

Osaka high-grade offices

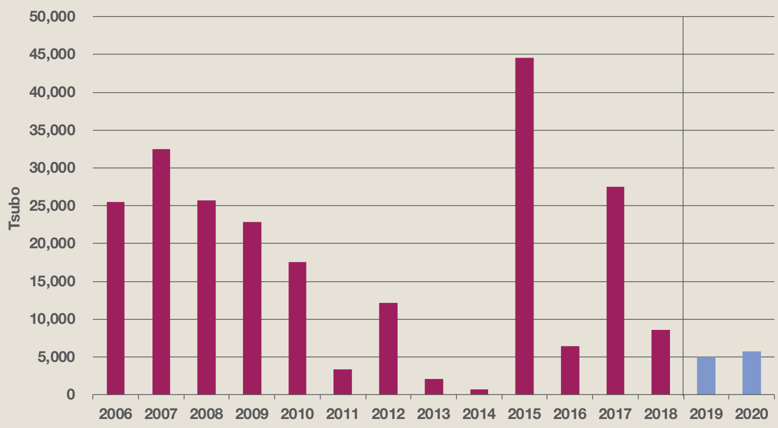
	2H/2018	HoH	YoY
Rent	20,700	4.0%	11.3%
Vacancy	0.8%	0.1ppts	-0.3ppts
Top rent	35,000+	+3,000	+3,000

Source: Savills Research & Consultancy

Nagoya

GRAPH 10

New NRA office supply in Nagoya, 2006 – 2020



Source: Sanko Estate, Savills Research & Consultancy

Nagoya office market

NRA

Total NRA in Nagoya stood at 1.0 million tsubo as of September, unchanged since May. A steady stream of completions is forecast through to 2020, distributed among relatively small projects. Volumes are significantly lower than the large spurts seen in 2015 and 2017.

Early 2018 saw the completion of Hirokoji Cross Tower, which has been fully let by MUFG Bank, Ltd. The nearest scheduled completion, the Yamaichi Building, due in early 2019, has been fully pre-leased by the Aichi Labour Bureau. Late 2019 will see the Kajima Fushimi Building, with approximately 3,200 tsubo, which has already managed to secure tenants. Further out, Mitsubishi Soko plans to complete the Meieki 1-chome project with 4,200 tsubo NRA in 2020, and Mitsui expects to complete the mixed-use Nagoya Mitsui Building North in 2021, adding almost 9,000 tsubo GFA to the market.

Supply is being readily absorbed, and pre-leasing is strong. Additionally, footfalls concentrate in the Meieki area more than before. Indeed, Nagoya City appears to recognise the situation, having proposed an urban revitalisation special district in Sakae, where the floor-to-area-ratio may be relaxed from 770% to 1,110%, which may bring about new developments. Preparation for the Linear Chuo Shinkansen bullet train is also likely to generate relocation demand in surrounding areas.

Vacancy

High-grade vacancy in Nagoya is the tightest of the three submarkets covered, and the pace of tightening is the fastest, at -1.3ppts YoY. Low vacancy is common across all of Nagoya; not a single submarket registered above 0.5% vacancy at the end of September, and the average was just 0.2%.

All-grade vacancy has tightened even faster, down 2.2ppts YoY to sit at 2.9% in September. All surveyed submarkets show vacancy below 3.4%. There is still room for compression in the all-grade market, particularly as space appears limited in high-grade.

Rent

High-grade office rents grew by 10.7% YoY on average, with Meieki recording a blistering 13.5% YoY growth to sit at JPY27,300 per tsubo per month, far in excess of the Nagoya average of JPY18,700. Neighbouring submarkets register much lower rents, clustering around the JPY15,000 level.

All-grade rents are more homogenous, with the market average

TABLE 6

Aichi prefecture key macro indicators*

	Japan	Tokyo	Aichi
Real GDP (JPY trillion)	537.6	103.6	**37.4**
Real GDP (YoY%)	1.3	1.8	**0.7**
% of Japan (2015)	100%	20%	**7%**
Population (million)	126.4	13.8	**7.5**
Job to applicant ratio	1.6	2.2	**2.0**

Source: Cabinet Office, Aichi Prefectural Government, Savills Research & Consultancy
*Real GDP for Japan is Q2/2018, for Tokyo, Aichi and % of Japan, 2015.

Nagoya (cont.)

at JPY11,100, though Meieki still leads the pack at JPY13,200. All-grade rents are far below the high-grade average, and growth rates are similarly lower, averaging 2.0% YoY, though Meieki managed growth of 4.2% YoY. Additionally, Sakae, the farthest submarket from Nagoya Station, shows signs of bottoming out.

Meieki
Asking rates for station-side tower locations range from JPY32,000 to over JPY35,000. Popular large-scale offices in the area, which can expect to achieve between JPY20,000 and JPY25,000 per tsubo per month, have driven high-grade rental growth on average.

Zero vacancy levels may be hindering leasing transaction volumes somewhat, possibly resulting in tenants moving down their wish list and taking the next available property.

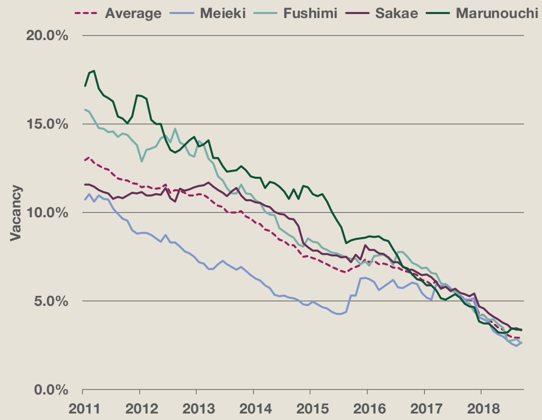
Fushimi and Marunouchi
High-grade rents in Fushimi and Marunouchi generally range between JPY14,000 to JPY17,000 per tsubo per month, but can exceed the range in some instances. The Kajima Fushimi Building, set to complete in 2019, is rumoured to be achieving rents at approximately JPY20,000. Buildings across the price spectrum have seen rental growth.

Outlook
While most cities see strong demand for prime locations, Nagoya's Meieki district commands high-grade rents far in excess of any other submarket, with commensurately impressive growth rates. Land prices around the station-front area are rising, following completions of towers adjacent to Nagoya Station. Due to a shortage of labour, companies in the city are required to attract a workforce even from neighbouring prefectures, which increases demand for convenient, station-front offices. The strong trend in this area is likely to go on.

Additionally, surrounding submarkets will see some development in the near term. In the Sakae area, NTT Urban Development is building an office building on the site of the former Sumitomo Corporation's Nagoya Building. Redevelopment of the Chubu Nippon Building and department store Maruei are also scheduled. In south east of Nagoya Station, Nagoya Railroad plans to utilise its owned site and improve integration with Nagoya Station.

GRAPH 11

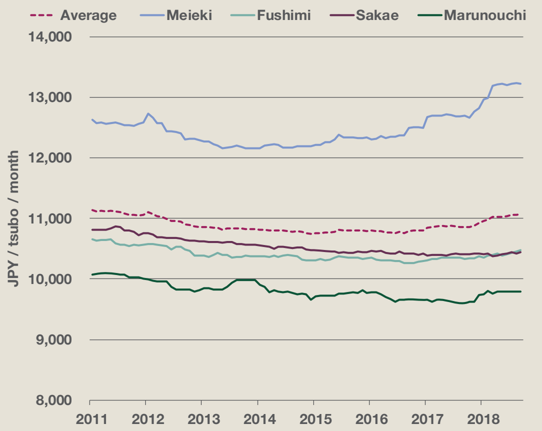
Vacancy rate in Nagoya by area, 2011 – Sep 2018



Source: Miki Shoji, Savills Research & Consultancy

GRAPH 12

Average rent in Nagoya by area, 2011 – Sep 2018



Source: Miki Shoji, Savills Research & Consultancy

TABLE 7

Nagoya high-grade offices

	2H/2018	HoH	YoY
Rent	18,700	2.9%	10.7%
Vacancy	0.2%	-0.2ppts	-1.3ppts
Top rent	35,000+	0	+5,000

Source: Savills Research & Consultancy

Fukuoka

Fukuoka office market

NRA

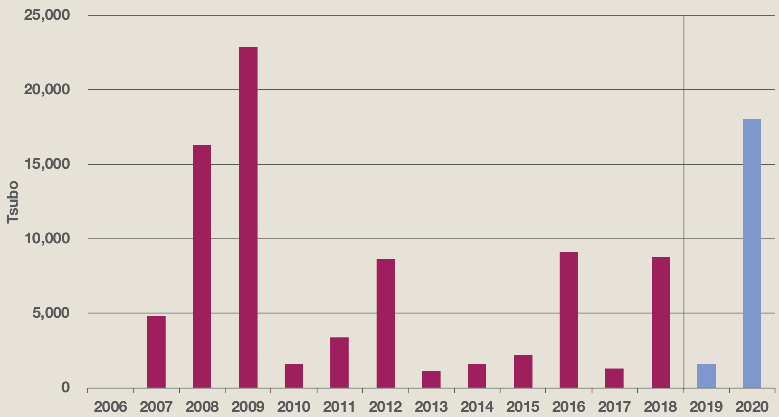
Total office NRA currently sits around 0.7 million tsubo, mostly unchanged since a construction boom in 2008 and 2009. Fukuoka City announced the Tenjin Big Bang Project in 2015, calling for the redevelopment of 30 old buildings in the Tenjin area over the next 10 years.

The market is seeing some renovation and repurposing of demand as a result of extremely tight vacancy, but landlords are struggling to find temporary homes for displaced tenants. Aeon Shoppers Fukuoka, for instance, will convert a total of 3,500 tsubo on the 5th to 8th floors for office use until 2024. Up to 7,000 tsubo is so far rumoured to have been converted from retail and self-occupied buildings to office space in attempts to meet strong demand. More space is needed for relocation for large redevelopment.

Early 2018 saw the completion of two projects, the JS Hakata Watanabe Building and the Kamiyo Hakata Chuo Building, both of which are fully leased and total approximately 7,600 tsubo NRA. The Kyushu Hakata Ekimae 1-chome redevelopment project, announced this year, is expected to bring 6,000 tsubo online in 2020.

GRAPH 13

New NRA office supply in Fukuoka, 2006 – 2020



Source: Sanko Estate, Savills Research & Consultancy

Tight conditions are likely to continue until 2021, which heralds the completion of the Tenjin Business Centre, the first target of the Tenjin Big Bang Project. Another Big Bang Project, the redevelopment of the Fukuzakuri Block at over 30,000 tsubo GFA, is scheduled to complete in 2023.

Vacancy

High-grade vacancy in Fukuoka widened 0.1ppts YoY to 0.4%, though the average all-grade vacancy rate fell 0.7ppts to 2.5% as of September 2018, with all surveyed submarkets except Hakata Station West now sitting at or below this level. Although vacancy in Akasaka remained the highest between 2016 and 2017, it has been rapidly tightening, indicating that demand is spreading outward.

WeWork is starting its operation in Daimyo in December, and there is already a rumour about its second location in Fukuoka. In April 2019, Regus is opening a Spaces location near Fukuoka Station. Spaces is a relatively new premium brand by Regus, and this is its third location in Japan after the openings in Nagoya and Otemachi in December 2016 and April 2017, respectively.

Rent

Average high-grade office rents in Fukuoka continue to see strong

TABLE 8

Fukuoka prefecture key macro indicators*

	Japan	Tokyo	Fukuoka
Real GDP (JPY trillion)	537.6	103.6	**18.2**
Real GDP (YoY%)	1.3	1.8	**2.1**
% of Japan (2015)	100%	20%	**4%**
Population (million)	126.4	13.8	**5.1**
Job to applicant ratio	1.6	2.2	**1.6**

Source: Cabinet Office, Osaka Prefectural Government, Savills Research & Consultancy
*Real GDP for Japan is Q2/2018, for Tokyo, Fukuoka and % of Japan, 2015.

Fukuoka (cont.)

growth, rising 8.7% YoY to stand at JPY17,300 per tsubo per month. All-grade rental growth is picking up speed, with YoY growth reaching 5.1% in September, continuing to set new records for YoY growth in Fukuoka. The average all-grade rent stood at JPY9,900 at the end of September.

Station Front
High-grade rent around Hakata Station averages JPY18,700 per tsubo per month, ranging from JPY17,000 to JPY23,000. Due to the tight market conditions, any available floors are getting snatched up without much of a marketing period, and older buildings are also ramping up rents.

LINE Fukuoka, which is headquartered in the JRJP Hakata Building, announced its partnership agreement with Fukuoka City in fields such as AI and Fintech in August. In October, the company also announced its plan to expand its sales force in the market.

Tenjin
High-grade rent in the Tenjin area has grown rapidly to range between JPY14,000 and JPY23,000 per tsubo per month, as stock towards the middle of the pack catches up to submarket leading rents. Tenjin is the most expensive submarket on an average rent basis, but may still have room to grow considering it is still below 2008 highs.

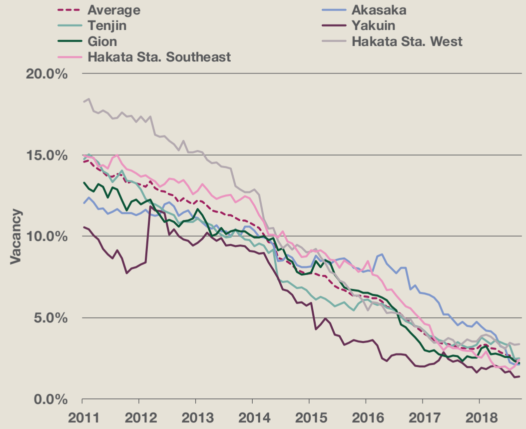
Outlook
Tight vacancy and urgency on the part of tenants is favouring landlords, who are emboldened to seek top rents. Rents have visibly picked up momentum since mid-2017, and short-term speed bumps do not appear on the horizon. Steady growth is likely to continue until the Tenjin Big Bang.

With supply limited in the near term, conversions from retail and other uses to office spaces are becoming common to accommodate pent-up office demand. Mina Tenjin and North Tenjin, which were acquired along with the E&Y Building for JPY26 billion in July by Fukuoka Standard Sekiyu, are rumoured to have been converted for office use.

Over the longer term, the Tenjin Big Bang Project should breathe new life into the regional market and push rents higher. Government tourism initiatives favour the region, which enjoys a close proximity to the rest of Asia. In addition, strong GDP growth and a seemingly tight employment market point to a healthy corporate sector, which should be able to shoulder rent increases.

GRAPH 14

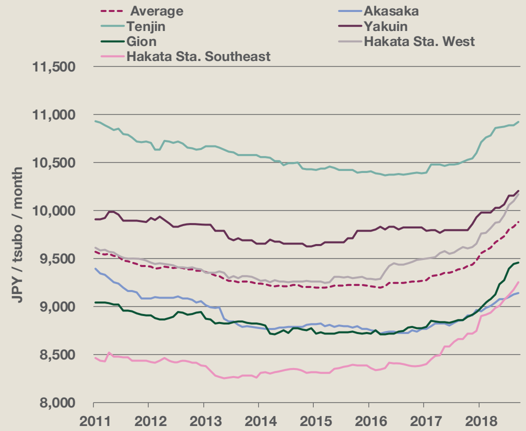
Vacancy rate in Fukuoka by area, 2011 – Sep 2018



Source: Miki Shoji, Savills Research & Consultancy

GRAPH 15

Average rent in Fukuoka by area, 2011 – Sep 2018



Source: Miki Shoji, Savills Research & Consultancy

TABLE 9

Fukuoka high-grade offices

	2H/2018	HoH	YoY
Rent	17,300	4.0%	8.7%
Vacancy	0.4%	0.1ppts	0.1ppts
Top rent	23,000+	0	+3,000

Source: Savills Research & Consultancy

Sendai

Sendai office market

NRA

As of September 2018, Sendai's office market totalled 0.5 million tsubo. Office demand in Sendai is driven by IT and software companies establishing customer support centres. Well-known examples include IBM, Amazon, and Mercari. Many companies consider the city's accessibility, a large pool of young IT talent, and financial support from the local government advantageous.

Construction has mostly been focused on redevelopments rather than expansions and new developments. For example, in October, First Bank Miyashin announced the sale of its ageing headquarters to Toyo Property and Chitose Kosan. Toyo Property plans to redevelop the old building into the tentatively-named Sendai Nishiguchi Ekimae Project, which is expected to complete in 2021 with a GFA of 2,200 tsubo.

Vacancy

Sendai's average all-grade vacancy rate dipped to 5.1% in September, tightening by 2.1ppts YoY. The Station Front and 1-bancho submarkets exhibit the tightest vacancy, at 3.9% and 4.1%, respectively. The Outer Area is showing 8.5% vacancy and tightened just 0.2ppts YoY, lagging behind other submarkets, implying demand is still concentrated around the central districts.

Co-working demand appears to be filling some space as well. In December, Regus plans to open its fifth location in Sendai, occupying about 600 tsubo in Kurax Sendai along Aoba-dori. Additionally, Enspace, operated by IT service company Enrise Corporation, opened a location in the 1-bancho submarket, occupying a seven-story building. The building features 80 individual office rooms and 100 co-working seats and targets demand for regional office branches and local entrepreneurs' office spaces.

Rent

All-grade rents in Sendai are relatively homogenous, ranging from JPY8,300 in the City Hall submarket to JPY10,400 in Station Front, though the Outer Area submarket averaged just JPY7,100 per tsubo per month at the end of September. Rent growth appears to have picked up its pace since the beginning of 2018, recording the highest YoY growth in September in a decade.

Station East has relatively high vacancy of over 7%, and it appears that the rent in the submarket has not bottomed out yet. As of this report date, the Yodobashi Camera Sendai Dai-ni Building, the only new supply to the submarket since 2012, is still listing over 1,500 tsubo at around JPY20,000 per tsubo per month.

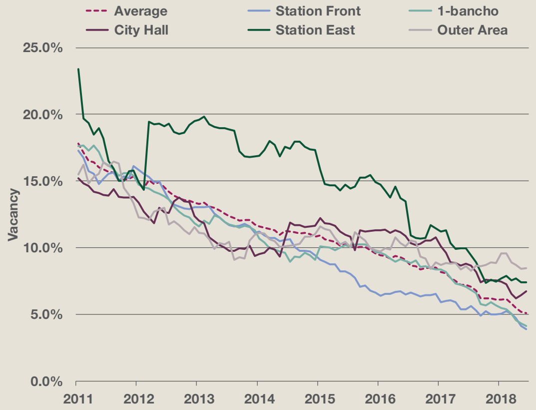
Outlook

Future growth of the local economy is expected to be mild and rental increases are likely to remain moderately positive. Tight vacancy across Japan may create demand for relatively affordable Sendai offices which still have available space. Although a lack of supply should keep vacancy low in the market, this also means that new office spaces are unlikely to be able to pull up rental averages.

The Station East submarket is undergoing a gradual redevelopment phase. The S-Pal Sendai East Building opened in 2016 and expanded in 2017. Construction of the Yodobashi Camera Sendai Dai-ichi Building is also expected to begin in 2019 with its target completion in 2021. The facility will feature a 300-room hotel, a 6,400 sq m music hall, and retail spaces. The opening of this building may attract more footfalls and improve the area's attractiveness for office tenants as well.

GRAPH 16

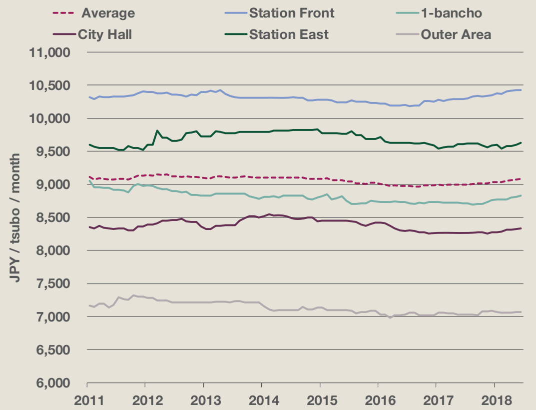
Vacancy rate in Sendai by area, 2011 – Sep 2018



Source: Miki Shoji, Savills Research & Consultancy

GRAPH 17

Average rent in Sendai by area, 2011 – Sep 2018



Source: Miki Shoji, Savills Research & Consultancy

TABLE 10

Miyagi prefecture key macro indicators*

	Japan	Tokyo	Miyagi
Real GDP (JPY trillion)	537.6	103.6	9.3
Real GDP (YoY%)	1.3	1.8	1.8
% of Japan (2015)	100%	20%	2%
Population (million)	126.4	13.8	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 Q2/2018, for Tokyo, Miyagi and % of Japan, 2015.

Sapporo

Sapporo office market

NRA

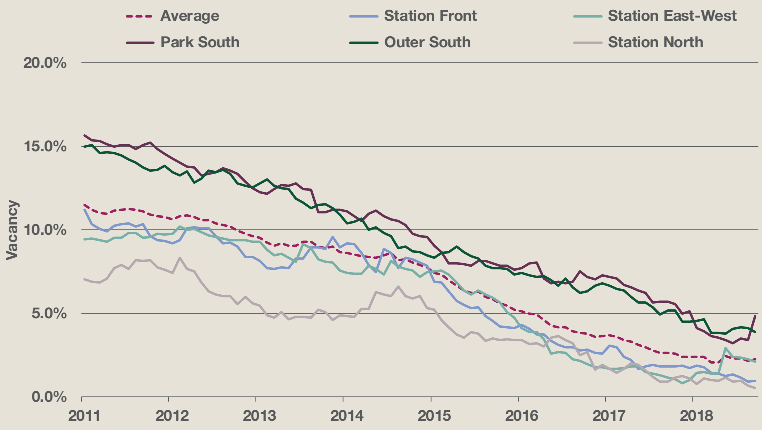
Sapporo's total office NRA is approximately 0.5 million tsubo, a figure which has remained relatively stable over the last decade. Over half of existing stock is located immediately to the south of Sapporo Station and along Odori Park.

Land prices have finally begun to tick up in Hokkaido, providing evidence of sound, persistent demand. New completions scheduled between now and 2020 might breathe new life into the market. According to a 2018 survey conducted by the Japan Real Estate Institute, 40% of office buildings in Sapporo were constructed prior to 1981, the highest amongst the twelve major cities studied in the survey. If new completions can achieve market-leading rents without much of a void period, redevelopment of older buildings may take place.

The recently completed Sapporo Sousei Square is the largest addition to NRA over the last few years, dwarfing the volume of supply expected over the next three years. 2019 will see the completion of two small-scale projects: the tentatively named Minami Odori Building North Ichijo, and the S1E3 Building, which have a combined GFA of approximately 4,000 tsubo.

GRAPH 18

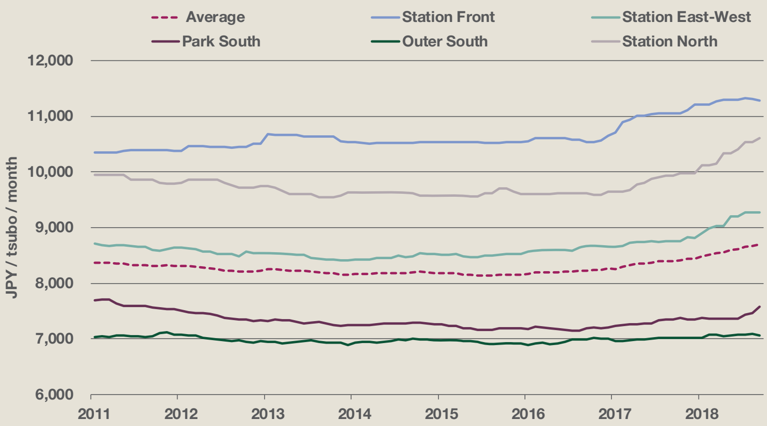
Vacancy rate in Sapporo by area, 2011 – Sep 2018



Source: Miki Shoji, Savills Research & Consultancy

GRAPH 19

Average rent in Sapporo by area, 2011 – Sep 2018



Source: Miki Shoji, Savills Research & Consultancy

TABLE 11

Hokkaido prefecture key macro indicators*

	Japan	Tokyo	Hokkaido
Real GDP (JPY trillion)	537.6	103.6	18.3
Real GDP (YoY%)	1.3	1.6	1.1
% of Japan (2015)	100%	20%	4%
Population (million)	126.4	13.8	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 Q2/2018, for Tokyo, Hokkaido and % of Japan, 2015.

Sapporo (cont.)

Renovation of the Daido Life Sapporo Building, which will integrate with transport infrastructure and help revitalise the surrounding neighbourhood, is expected to complete in 2020.

Vacancy

The average all-grade vacancy rate for Sapporo as of September 2018 was 2.3%. Vacancy is particularly tight to the north and directly south of the station, at 1% or less. Beyond the station, vacancy is 3.9% in the Outer South submarket and 4.8% in Park South.

On a YoY basis, vacancy has been tightening in all submarkets except to the East and West of the Station, where Sapporo Sousei Square added an additional 7,500 tsubo of leasable office space. According to Miki Shoji's data, the building still appears to be over 25% vacant after five months in operation. Additionally, vacancy ticked up in Park South, possibly due to the office conversion of the former Tokyu Hands Sapporo building.

Rent

All-grade rents bottomed out in January 2016, and rental growth is accelerating and reached 3.6% YoY in September. Station North in particular has seen fantastic growth of above 5.0% YoY since April. Considering that the submarket's discount from Station Front was widening until 2017, office buildings in Station North appear to have prioritised filling vacancy, but recently shifted their focus on increasing rents, encouraged by strengthening market fundamentals.

Sapporo Sousei Square appears to have bolstered YoY rental growth in the Station East-West submarket, which saw growth rates pick up from 3.2% in April to 5.3% in May. The market appears to be maintaining this momentum as rents grew 5.9% YoY in September.

Outlook

As supply has been relatively limited in the last decade, Sapporo's office stock is ageing. Following the recent earthquake, newer buildings higher business continuity planning (BCP) specifications, such as Sapporo Sousei Square, may gain more popularity. In the long-term, the planned extension of the Hokkaido Shinkansen from Hakodate to Sapporo by 2030 may facilitate redevelopment in the market.

That being said, Sapporo's economy lacks a strong long-term growth driver. Office spaces of regional branches could be reconsidered if the economy were to turn south.

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