Savills World Research
Japan

Spotlight
Regional Japanese office markets

July 2017

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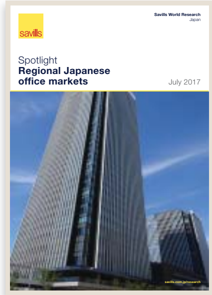


"High-grade offices in select cities are clearly outperforming Tokyo offices. Increases in top rents are also noticeable. Encouraged by strong metrics, more investors are expected to turn their eyes beyond the capital city."

High-grade offices

Based on Savills' high-grade office portfolio[1], market metrics in regional cities have improved over the past year. High-grade offices in Osaka, Nagoya, and Fukuoka have performed especially well and their growth pace has exceeded that of Tokyo.

Fukuoka improved its already tight vacancy by 1.0 percentage points (ppts) to an impressive 0.4%, and rents have grown 8.8% YoY. Osaka has seen the largest vacancy tightening as Grand Front Osaka now operates at full capacity. Nagoya maintained tight vacancy despite consecutive openings of station front buildings. New high-quality offices have helped increase average rents.

Overall, we have seen rental growth in buildings with high rents in each market. There were several buildings in which rents have risen by over 20%. This indicates that investors can reap handsome returns by identifying promising assets in regional cities.

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 attractive yield gaps of 1.0 to 2.0ppts over Tokyo, but actual market yield gaps have been tighter.

According to Real Capital Analytics (RCA), Tokyo's share of Japan's real

1 In each of Osaka, Nagoya, and Fukuoka, Savills monitors 40 to 50 "high-grade offices" typically with a GFA of over 15,000 sq m (4,537 tsubo) and a building age of less than 25 years.

TABLE 1

High-grade office performance, May 2017

	Vacancy	YoY ppts	Rent	YoY
Osaka	1.8%	-2.3	17,800	+4.9%
Nagoya	2.4%	+0.6	16,700	+3.1%
Fukuoka	0.4%	-1.0	14,700	+8.8%

Source: Savills Research & Consultancy

TABLE 2

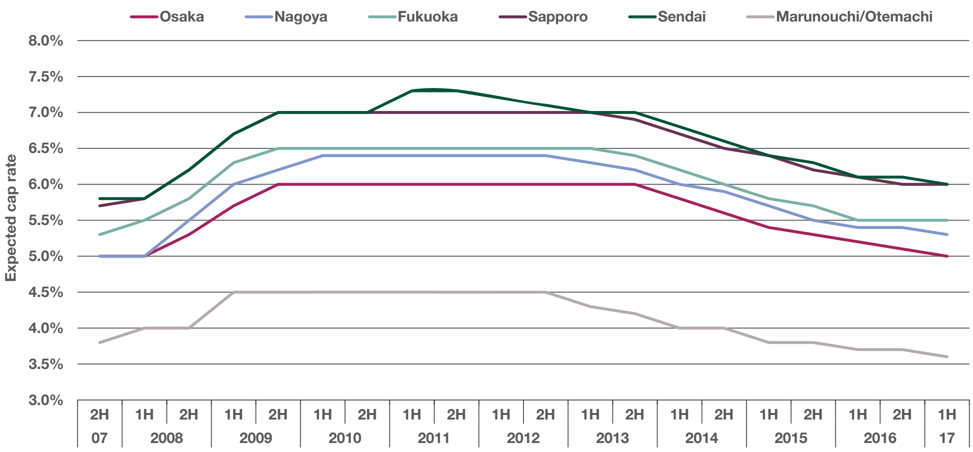
All-grade office performance, May 2017

	Vacancy	YoY ppts	Rent	YoY
Osaka	4.2%	-2.1	11,134	+0.4%
Nagoya	5.8%	-1.2	10,873	+1.0%
Fukuoka	3.4%	-2.3	9,354	+1.2%

Source: Miki Shoji, Savills Research & Consultancy

GRAPH 1

Cap rates for office buildings, 2H/2007–1H/2017



Source: JREI, Savills Research & Consultancy estate transactions fell to just 42% in 1H/2017. Major suburban areas such as Yokohama and Saitama have seen higher volumes, which has resulted in a larger share of transactions recorded outside of major cities. Total transaction volumes reported in Osaka, Nagoya, Fukuoka, Sendai, and Sapporo totalled JPY280 billion, or 48% of volumes in Tokyo. This is a 5.6ppts increase from the previous year. Investors are increasingly searching for opportunities outside the capital city.

Osaka especially is attracting investor interest. In March, Hulic purchased the Midosuji MID Building from MCUBS MidCity for JPY9 billion at an NOI yield of 3.7%. Hulic also acquired four office and retail buildings in Shinsaibashi for a rumoured JPY38 billion in June. The company had previously shied away from investments outside of Tokyo; these recent transactions in Osaka signal a policy shift.

All-grade offices

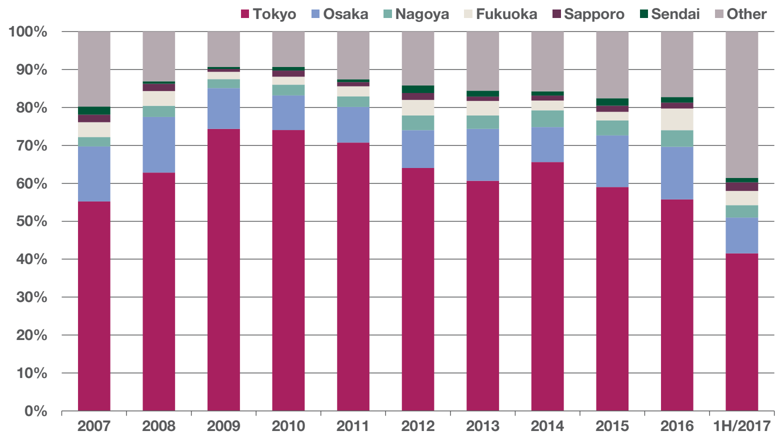
According to Miki Shoji, demand for office space in regional cities continues to grow. All-grade office vacancy continues to tighten at a steady pace. Vacancy in Sapporo and Fukuoka reached pre-recession lows in late 2014 and early 2015 and have since continued to tighten. In April, Osaka achieved its tightest vacancy reading since the financial crisis. Limited new supply is helping keep markets tight.

Supported by this strengthening vacancy trend, select submarkets have recently shown signs of rental increases. For instance, Meieki in Nagoya and Umeda in Osaka saw respective YoY all-grade rental increases of 3.0% and 1.9% in May.

Overall all-grade rental growth in regional markets remains relatively slow. This is partially attributable to the fact that tenants able to afford high rents concentrate in Tokyo. Graph 3 shows total revenue shares of publicly traded companies headquartered in key regional prefectures. Almost three quarters of the total revenue generated by these firms is generated by those headquartered in Tokyo.

GRAPH 2

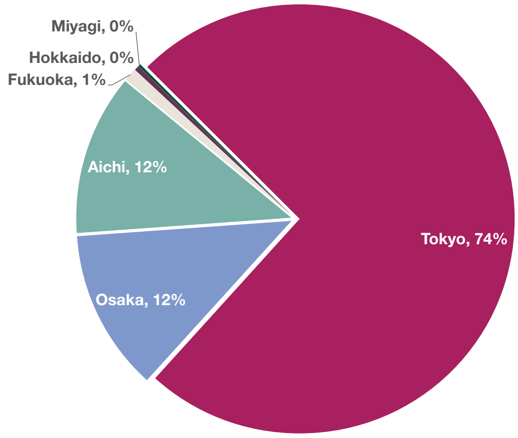
Investment volumes by area for all asset classes, 2007–1H/2017



Source: RCA, Savills Research & Consultancy

GRAPH 3

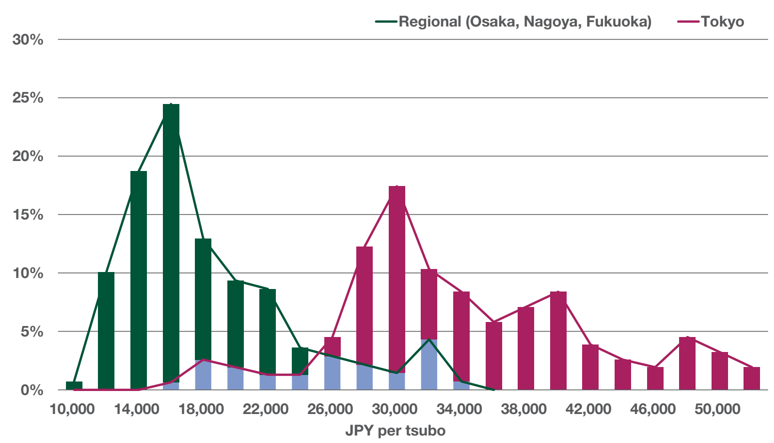
Revenue share of publicly-traded companies headquartered in key regional prefectures*, Jun 2017



* These prefectures include key regional cities analysed in this report.
Source: Company disclosures, Savills Research & Consultancy

GRAPH 4

Office rent distribution in regional markets vs Tokyo



Source: Savills Research & Consultancy

That high concentration of corporations in the capital city is reflected in office rent distributions. Graph 4 shows that rents for a majority of high-grade offices in regional cities fall below JPY18,000 per tsubo while high-grade rents in Tokyo typically exceed JPY30,000.

Having said that, rents for superior assets in Osaka and Nagoya can also exceed JPY30,000 per tsubo. Additionally, as discussed earlier, rental growth of high-grade offices has been improving faster than growth in all-grade offices. Considering recent openings of high-quality offices and limited supply in regional cities, more regional offices may become able to charge rents comparable with the Tokyo market, which is expecting a glut of supply in the coming years.

Furthermore, soaring demand for workers is creating favourable conditions for the office market. Tokyo's job-to-application ratio hit 2.1x in April, and other prefectures are not far behind.

In recent years, the large labour supply-demand gap has been filled mainly by previously underutilised female employees on or returning from maternity leave, as well as elderly workers. According to data from the Ministry of Internal Affairs and Communications, the nationwide employment rate of women between the ages of 15 and 64 has grown from 60% to 66% from 2010 to 2016. Furthermore, Graph 5 illustrates that a large portion of labour increases in regional cities were supplied by workers over 65.

Despite the entrance of these new workers, demand for labour still exceeds supply. To bring balance to the labour market, meaningful wage increases must happen. Wage increases have already materialised for low-income workers. Broad-based wage growth is now more likely than before. If it begins to spread to wider demographics, real estate markets as a whole should benefit from stronger consumer confidence and moderate inflation.

Outlook

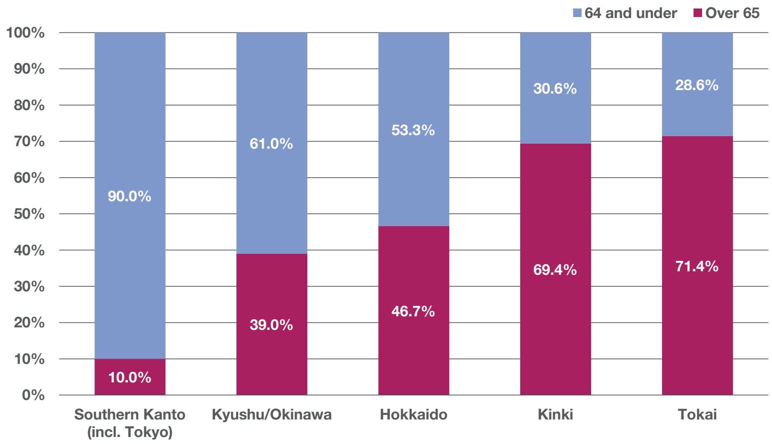
Supported by stable local economies, regional real estate markets have shown some positive signs. Increasing labour demand across the country appears to be bolstering office demand in surveyed cities.

Vacancy continues to tighten as companies show demand for relocation and expansion. Companies appear more willing to tolerate rental increases under current low-vacancy conditions. In light of strong demand and constrained supply, forces appear to be in place for further rental growth.

Tightening cap rates in regional cities reflect these positive stories. Regional yield gaps vs Tokyo remain attractive, however, and rents are expected to grow. As such, more investors are expected to search for opportunities beyond the capital city.

GRAPH 5

Age breakdown of regional workforce increases, 2010-2016*

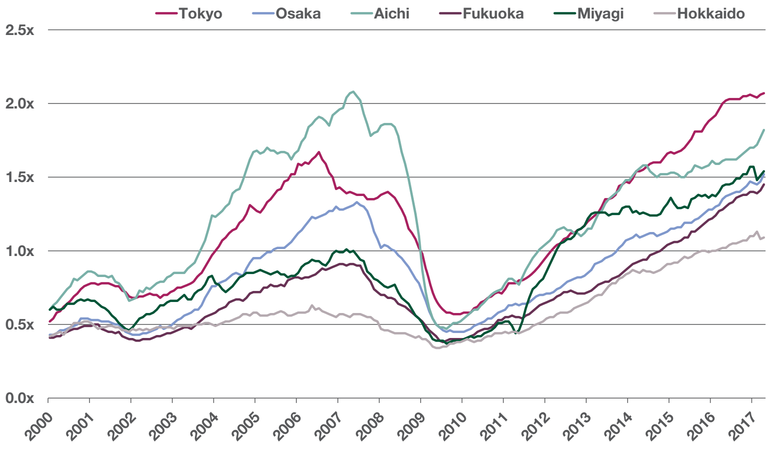


*Data excludes agricultural and forestry employees.

Source: Ministry of Internal Affairs and Communications, Savills Research & Consultancy

GRAPH 6

Job-to-application ratio, selected prefectures, Jan 2000–Apr 2017



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

Osaka

Osaka office market

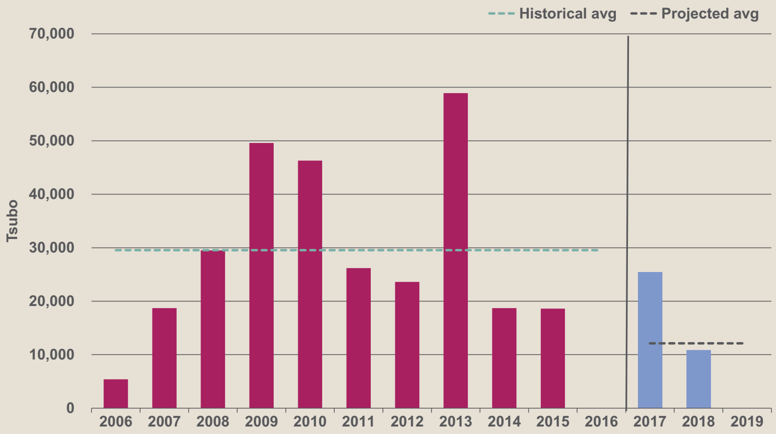
Net Rentable Area (NRA)

Osaka's total NRA stood at 2.2 million tsubo as of May 2017. Nakanoshima Festival Tower West completed in April, adding over 20,000 tsubo NRA to the market. Major new projects in the pipeline include Shin Nankai Kaikan in late 2018 and the Hankyu Hanshin Building in 2022.

Additionally, the Umeda San-chome Project, which had been delayed, appears to be back on track. Japan Post has released its new construction schedule for the B2/40F mixed-use building. The office space is expected to be over 40,000 tsubo and the whole project is scheduled for completion in 2022.

GRAPH 7

New NRA office supply in Osaka, 2006–2019E



Source: Sanko Estate, Savills Research & Consultancy

Vacancy

High-grade office vacancy in Osaka has tightened 2.3ppts YoY and stood at 1.8% in May.

Meanwhile, all-grade vacancy stood at 4.2% in May, down 2.1ppts from a year earlier. Shinsaibashi-Namba recorded the largest YoY tightening of 3.5ppts to 4.4%.

All-grade vacancy in Umeda achieved 3.0% and further tightened to 2.5% in May. The Nikkei reported that Nakanoshima Festival Tower West hosts about 30 companies and tenants have been decided for about 90% of its floor space. Key tenants include Asahi Group Holdings, Canon, Dentsu, and Teijin. It is also rumoured that IBM plans to lease several floors in the building.

Rent

Average rents for high-grade office space in Osaka have risen 4.9% YoY to JPY17,800 per tsubo. Rents of several high-quality assets now reach JPY30,000 per tsubo.

Average all-grade rents have been growing for four consecutive months after over one year of declines. Average all-grade rents across the city stood at JPY11,134 per tsubo as of May, a 0.4% increase YoY. Rental growth in Umeda has shown signs of picking up, posting 1.6% and 1.9% YoY increases in April and May respectively. With vacancy continuing to tighten, rental growth may further accelerate.

Umeda

Contract rents for high-grade offices in Umeda and Nakanoshima range from JPY12,000 to 30,000 per tsubo per month. Top rents are mainly visible in high-quality buildings such as the Yoshimoto Dai-ni Building and Umeda Hankyu Office Center.

According to the Nikkei, average rents in the newly completed Nakanoshima

TABLE 3

Osaka prefecture key macro indicators*

	Japan	Tokyo	Osaka
Real GDP (JPY trillion)	525.2	100.7	**39.4**
% of Japan	100%	19%	**8%**
Population (thousands)	126,740	13,726	**8,832**
Job to applicant ratio	1.5	2.1	**1.5**

Source: Cabinet Office, Osaka Prefectural Government, Savills Research & Consultancy
* Real GDPs for Japan, Tokyo, and Osaka are for Q1/2017, 2016, and 2015 respectively.

Osaka (con't)

Festival Tower West range from JPY20,000 to 22,000 per tsubo per month. Additionally, the Sakurabashi Miyuki Building is scheduled for completion in October 2017 and is seeing active pre-leasing. It is rumoured that the target rent is about JPY22,000 per tsubo per month.

Yodoyabashi-Honmachi

Contract rents for high-grade offices in Yodoyabashi and Honmachi range from JPY10,000 to 25,000 per tsubo per month.

All-grade vacancy in Yodoyabashi and Honmachi has rapidly improved since loosening in 2015, when large tenants relocated to new corporate-owned office buildings. As of May, all-grade vacancy in the submarket stood at 4.5%, tighter by 2.4ppts YoY.

The Shinanobashi Fuji Building was completed in June 2017 and reportedly started operations at high occupancy due to active pre-leasing.

Shin-Osaka

Contract rents for high-grade offices in Shin-Osaka are ranging from JPY12,000 to 21,000 per tsubo per month.

All-grade vacancy in Shin-Osaka remains tight at 4.4% in May and relocations in the area continue to be difficult.

Outlook

Office demand in Osaka continues to strengthen. Vacancy is tightening despite the opening of Nakanoshima Festival Tower. Since many companies possess their own office buildings in Osaka, relocations from aging, company-owned buildings to leased office spaces also generate new demand.

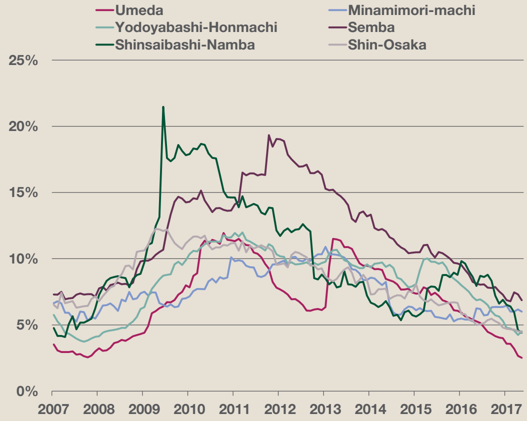
In light of surging inbound tourism in Osaka, a majority of development projects are either retail or hotel assets. As such, future office supply is limited and concentrated in the Umeda area.

Although companies in Osaka are traditionally very reluctant to accommodate rental increases, tightening vacancy has begun to change that mentality. With little expansion or relocation opportunities available, companies are more willing to loosen their purse strings to secure favourable spaces.

As rents have started showing signs of growth, more investors may turn to Osaka and seek office properties at more attractive prices relative to Tokyo. The local government is hoping to secure the rights to host the 2025 World Expo – if successful, it would be a boost for the market.

GRAPH 8

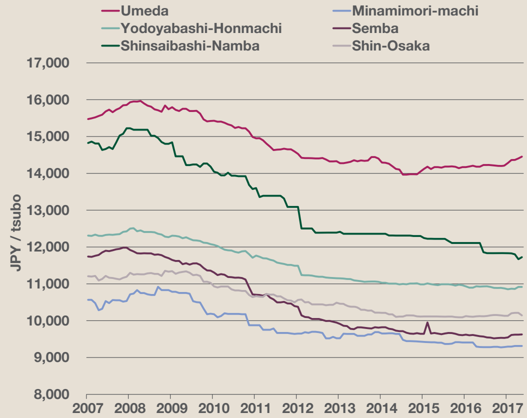
All-grade vacancy rate in Osaka by area, 2007–May 2017



Source: Miki Shoji, Savills Research & Consultancy

GRAPH 9

All-grade average rent in Osaka by area, 2007–May 2017



Source: Miki Shoji, Savills Research & Consultancy

TABLE 4

Osaka high-grade office

	1H/2017	HoH	YoY
Rent	17,800	2.3%	4.9%
Vacancy	1.8%	-0.2ppts	-2.3ppts
Top rent	30,000+	over 10%	over 10%

Source: Savills Research & Consultancy

Nagoya

Nagoya office market

NRA

Total NRA in Nagoya stood at 1.0 million tsubo as of May 2017. The opening of JR Gate Tower in February and Global Gate Tower in March expanded the market size by about 12,000 tsubo. Six out of seven major office buildings completed since 2015 are in the Meieki submarket, facilitating company relocations to the station front area.

Development is continuing in the Meieki area. In March, Meitetsu released its redevelopment plan in the area directly south of Nagoya Station. The company's plan features a 30-storey mixed-use building with office, residential, retail, and hotel components. Construction is scheduled to commence in 2022. The project also includes doubling the size of Meitetsu Nagoya Station, which is scheduled to complete in time for the Linear Chuo Shinkansen bullet train's opening in 2027.

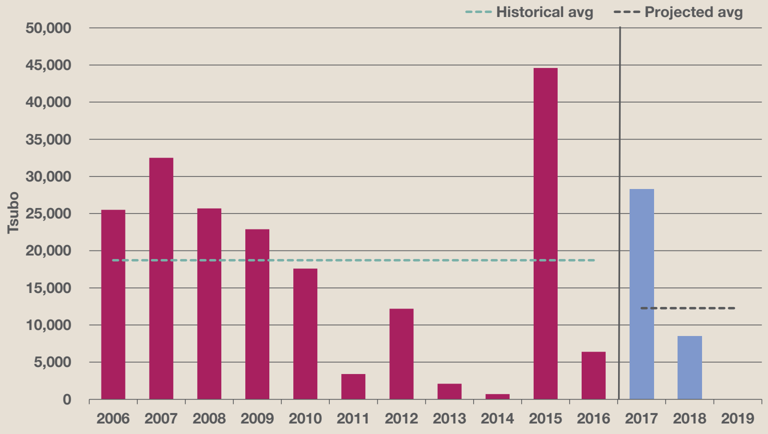
Vacancy

High-grade vacancy in Nagoya has loosened 0.6ppts YoY, but tightened 0.8ppts HoH, and stood at 2.4% in May.

All-grade vacancy has been trending steadily tighter since 2010, and stood at 5.8% as of May, a 1.2ppt tightening YoY.

GRAPH 10

New NRA office supply in Nagoya, 2006–2019E



Source: Sanko Estate, Savills Research & Consultancy

While JR Gate Tower opened close to full occupancy, Global Gate Tower West began operation approximately 30% vacant. This is largely due to delays in the extension of an underground passage from Nagoya Station. However, this level of vacancy should not affect the city's overall trend given limited supply.

Demolition of several office buildings for the construction of a new bullet train station may further tighten the market.

Rent

Average rents of high-grade offices in Nagoya have risen 3.1% YoY to JPY16,700 per tsubo.

All-grade rents in Nagoya averaged JPY10,873 per tsubo in May, increasing 1.0% YoY. In addition to the resilient Meieki submarket, Fushimi has also started gradual rental growth.

Although rents in Sakae and Marunouchi continue to fall on a YoY basis, the declining pace has been slowing, indicating that these submarkets may be close to bottoming out. Redevelopment projects such as the Chubu Nihon Building and the Nishiki Ni-chome Project are also increasing the overall competitiveness of available assets.

TABLE 5

Aichi prefecture key macro indicators*

	Japan	Tokyo	Aichi
Real GDP (JPY trillion)	525.2	100.7	**36.0**
% of Japan	100%	19%	**7%**
Population (thousands)	126,740	13,726	**7,517**
Job to applicant ratio	1.5	2.1	**1.8**

Source: Cabinet Office, Aichi Prefectural Government, Savills Research & Consultancy
* Real GDPs for Japan, Tokyo, and Aichi are for Q1/2017, 2016, and 2014 respectively.

Nagoya (con't)

Meieki
Contract rents for high-grade offices in Meieki range from JPY13,000 to 30,000 per tsubo per month.

The new JR Gate Tower boasts the top rent in the submarket, having major companies as its tenants. Some key tenants include Fujitsu, Suntory, Sumitomo Corp., Deloitte Tohmatsu, and SoftBank Technology.

Rents paid by tenants in the offices located on the development site of the bullet train station are around JPY16,000 per tsubo, much less than rents in towers at the station front. Upon demolition, many of these tenants are likely to relocate to other submarkets for affordable spaces.

Fushimi and Marunouchi
Contract rents of high-grade offices in Fushimi and Marunouchi are averaging from JPY10,000 to as high as JPY20,000 per tsubo per month.

Although multiple companies have relocated to high-quality offices in Meieki, active leasing is taking up the slack in these areas. All-grade vacancies in Fushimi and Marunouchi respectively strengthened by 1.5ppts YoY to 5.9% and by 3.3ppts YoY to 5.1% as of May.

The Nishiki Ni-chome Project in Fushimi is scheduled for completion in 2018 and the Bank of Tokyo Mitsubishi UFJ will lease the whole building.

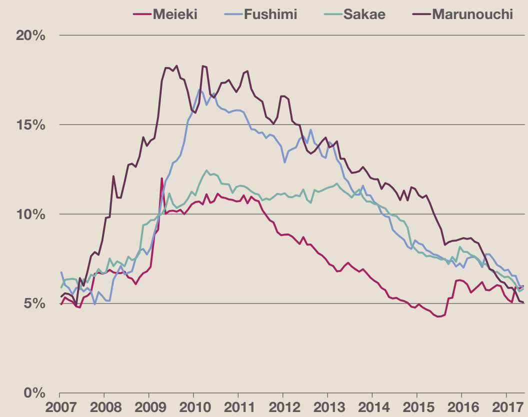
Sakae
Contract rents for high-grade offices in Sakae range from JPY10,000 to 18,000 per tsubo. Average all-grade rents edged down 0.3% YoY to JPY 10,388 per tsubo.

All-grade vacancy in Sakae tightened 1.7ppts YoY to 5.8% in May. There is little future supply in this area. Additionally, the planned redevelopment of the Chubu Nihon Building may further push down the vacancy in the short term.

Outlook
In the Nagoya market, Meieki continues to draw office demand and leads rental growth. Continuing development around Nagoya Station poses potential for further growth.

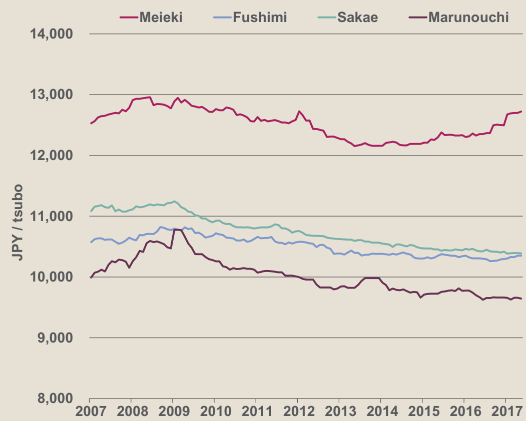
Overall vacancy is still tightening, indicating that secondary vacancy is being absorbed efficiently. The market remains tight, and conditions appear favourable for further rental growth.

GRAPH 11
All-grade vacancy rate in Nagoya by area, 2007–May 2017



Source: Miki Shoji, Savills Research & Consultancy

GRAPH 12
All-grade average rent in Nagoya by area, 2007–May 2017



Source: Miki Shoji, Savills Research & Consultancy

TABLE 6
Nagoya high-grade office

	1H/2017	HoH	YoY
Rent	16,700	3.1%	3.1%
Vacancy	2.4%	-0.8ppts	0.6ppts
Top rent	30,000	0.0%	0.0%

Source: Savills Research & Consultancy

Fukuoka

Fukuoka office market

NRA

Total NRA in Fukuoka's office market currently sits at 700,000 tsubo. In 2016, newly-built offices such as the JRJP Hakata Building and the C9 Building added about 7,000 tsubo in the Station Front area. Despite the supply increase, strong demand for expansion or redevelopment-driven relocation to the city centre have helped absorb secondary vacancy.

Although new supply such as the Kamiyo Sumiyoshi Yon-chome Project and the Kamiyo Hakata Chuo Building will enter the market in 2018, pre-leasing appears to be active. Thus, market vacancy is expected to remain very tight at least until the mixed-use Tenjin Business Centre opens in 2020 with a GFA of 18,000 tsubo.

Vacancy

Vacancy of high-grade offices in Fukuoka has tightened an additional 1.0ppts YoY and stood at an extremely tight 0.4% in May.

Fukuoka's all-grade vacancy rate has continued to set record lows and reached 3.4% in May.

Station Front recorded the tightest all-grade vacancy at 2.7%, followed by Yakuin and Station East & South at 2.9% and 3.0% respectively. Due to the tight conditions, available spaces are limited to blocks of around 30 tsubo, which makes it hard for large companies to expand or relocate. With multiple office buildings planned to be redeveloped, vacancy is not expected to loosen anytime soon.

Additionally, strong lodging demand from inbound tourism continues to attract hotel developments. Some mixed-use development projects were originally expected to have office floors but have since opted to include only hotel and retail space.

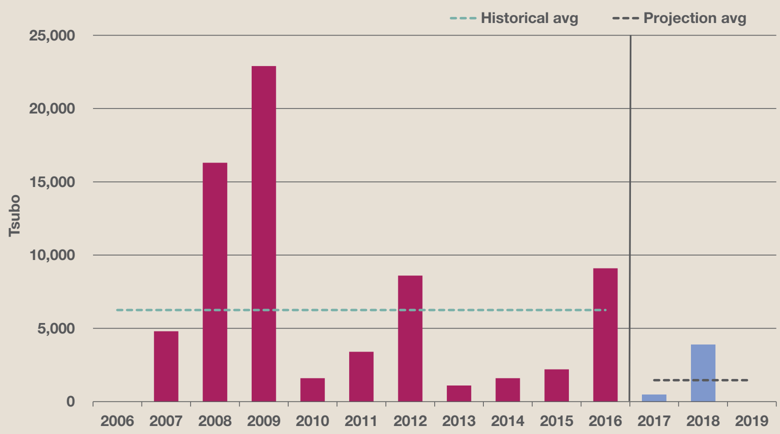
Rent

Average rents for high-grade offices in Fukuoka have risen 8.7% YoY to JPY14,700 per tsubo.

All-grade office rents are beginning to see steady increases and currently stand at JPY9,354 per tsubo per month, a 1.2% increase YoY. In March, the market experienced 1.4% YoY growth, the largest YoY gain since the financial crisis. As vacancy is expected to remain tight, steady rental growth should continue in the near term. Redevelopment of older buildings should also positively affect the overall rental trend.

GRAPH 13

New NRA office supply in Fukuoka, 2006–2019E



Source: Sanko Estate, Savills Research & Consultancy

TABLE 7

Fukuoka prefecture key macro indicators*

	Japan	Tokyo	Fukuoka
Real GDP (JPY trillion)	525.2	100.7	**18.6**
% of Japan	100%	19%	**4%**
Population (thousands)	126,740	13,726	**5,107**
Job to applicant ratio	1.5	2.1	**1.5**

Source: Cabinet Office, Osaka Prefectural Government, Savills Research & Consultancy
* Real GDPs for Japan, Tokyo, and Fukuoka are for Q1/2017, 2016, and 2014 respectively

Fukuoka (con't)

Station Front
The Hakata Station Front area achieved the tightest vacancy in Fukuoka in May. Contract rents of high-grade offices in this submarket range from JPY14,000 to 20,000 per tsubo per month.

Pre-leasing for the C9 Building, which completed in December, was strong and the building is now almost fully leased. Additionally, the Kamiyo Hakata Chuo Building and Kamiyo Sumiyoshi Yon-chome Project are likely to fill most of their floors by completion in 2018.

The large site purchased by JR from social app company LINE was originally scheduled to include office floors. However, the plan has been recently revised to contain only retail and hotel space, further squeezing office vacancy.

Tenjin
The Tenjin area contains high-grade offices such as the Urbannet Tenjin Building and the Acros Fukuoka Building. Contract rents for high-grade offices in Tenjin range from JPY13,000 to 20,000 per tsubo per month.

As mentioned in our previous report, railway company Nishitetsu plans to redevelop the Fukuoka Building and the adjacent retail complex Tenjin Core, but the company appears to still be having difficulty relocating current tenants.

With few office spaces available in the market, the new Tenjin Business Center is expected to provide some breathing room and help absorb pent-up demand. As a unique landmark of the Tenjin Big Bang initiative, the centre is aiming for an ambitious rent of JPY30,000 per tsubo for office space.

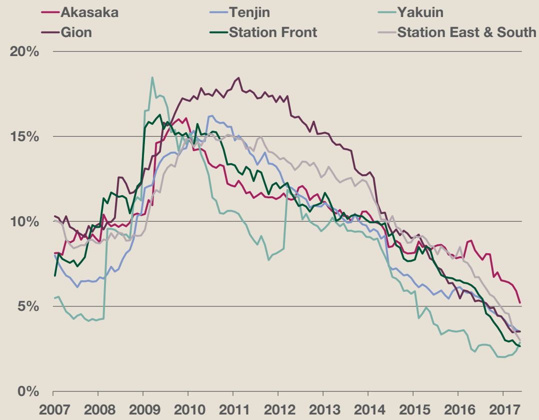
Outlook
Office demand in Fukuoka has been strengthening and vacancy remains very low in all of the submarkets as new supply is quickly absorbed through active pre-leasing. Tight market conditions are expected to continue until large office space is supplied.

Average rents in Fukuoka are beginning to see steady increases as owners try to capitalise on strong occupancy.

Additionally, the government's Tenjin Big Bang initiative will relax height regulations and aims to bring about redevelopment of 30 office buildings by 2024. In the short term, redevelopments should reduce NRA and further tighten the market. In the medium to long term, overall competitiveness of the market will improve after possible temporary softness.

GRAPH 14

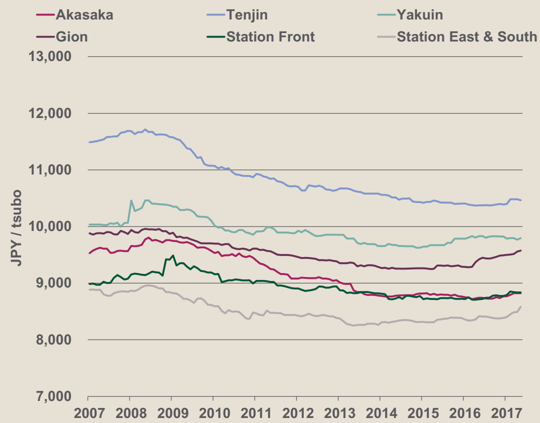
All-grade vacancy rate in Fukuoka by area, 2007–May 2017



Source: Miki Shoji, Savills Research & Consultancy

GRAPH 15

All-grade average rent in Fukuoka by area, 2007–May 2017



Source: Miki Shoji, Savills Research & Consultancy

TABLE 8

Fukuoka high-grade office

	1H/2017	HoH	YoY
Rent	14,700	8.8%	8.7%
Vacancy	0.4%	-0.5ppts	-1.0ppts
Top rent	20,000	0.0%	0.0%

Source: Savills Research & Consultancy

Sendai

Sendai office market

NRA

Sendai's office market totalled 465,000 tsubo as of May 2017. After over two years of no supply, the Nomura Fudosan Sendai Aoba-dori Building added an NRA of about 2,600 tsubo in the Station Front area in April 2017. The building is the first office building in Sendai equipped with an emergency generator, which supplies 72 hours of power. Although future supply is limited as of this report, the market may attract some developer interest as occupancy continues to strengthen and rents began to increase in select areas.

Vacancy

Sendai's citywide vacancy rate sits at 8.1% as of May 2017, a tightening of 1.3ppts YoY. The Station Front area has maintained the tightest vacancy in Sendai at 6.0% despite the opening of the Nomura Fudosan Sendai Aoba-dori Building in April. According to Miki Shoji's data, the office building started its operation almost fully leased. The first floor of the new building is occupied by Aomori Bank, and Fujitsu Systems Application & Support has also relocated its regional headquarters from the Station East area to this building.

Although Station East registers the highest vacancy rate in Sendai, the submarket's vacancy began to rapidly tighten towards the end of 2016. The large vacancy decrease may be related to the opening of IBM's Sendai Client Innovation Center in this area. The company reportedly plans to hire about 300 engineers. Ericsson Japan also has started its operation in June in the Sendai MT Building. Over ten IT companies including Amazon are reportedly moving to Sendai in 2017, taking advantage of the city's accessibility, a large pool of young IT talent, and financial support from the local government. In total, over 1,500 people are expected to be employed according to local media.

Rent

Average rents in Sendai stood at JPY8,987 per tsubo per month in May 2017, edging down by 10bps. Relatively high vacancy appears to be holding back rental increases in this market.

However, average rents in the Station Front area began to show some signs of bottoming out in recent months. For five consecutive months, the submarket has recorded positive YoY growth and reached JPY10,257 per tsubo per month in May. Station Front's positive performance is due to strengthening occupancy, which is now approaching 95%. As overall occupancy of Sendai is likely to continue to strengthen, rental growth may begin in other submarkets as well.

TABLE 9

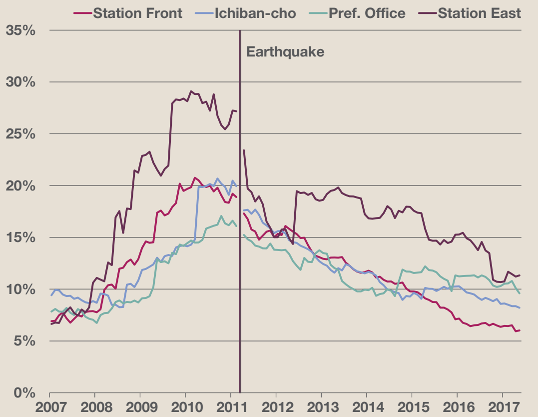
Miyagi prefecture key macro indicators*

	Japan	Tokyo	Miyagi
Real GDP (JPY trillion)	525.2	100.7	9.5
% of Japan	100%	19%	2%
Population (thousands)	126,740	13,726	2,323
Job to applicant ratio	1.5	2.1	1.5

Source: Cabinet Office, Miyagi Prefectural Government, Savills Research & Consultancy
* Real GDPs for Japan, Tokyo, and Miyagi are for Q1/2017, 2016, and 2015 respectively.

GRAPH 16

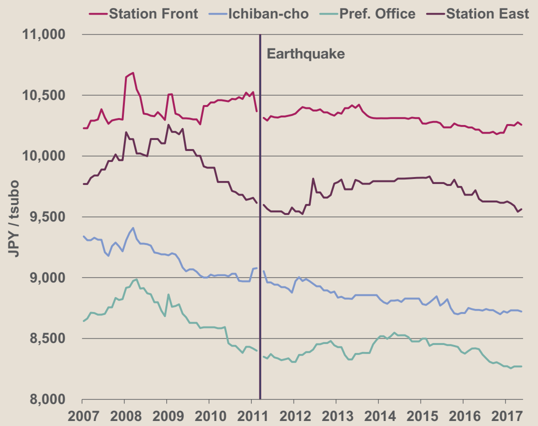
All-grade vacancy rate in Sendai by area*, 2007–May 2017



Source: Miki Shoji, Savills Research & Consultancy
* No data available for March 2011

GRAPH 17

All-grade average rent in Sendai by area*, 2007–May 2017



Source: Miki Shoji, Savills Research & Consultancy
* No data available for March 2011

Outlook

Gradually declining vacancy in Sendai indicates sound recovery of office demand. The Station Front area has been leading Sendai's recovery and registered some rental increases as area vacancy continues to set record lows.

With the city drawing major IT companies, overall market attractiveness is expected to continue to improve. Continued IT sector growth in Sendai would give the local economy additional momentum.

Sapporo

Sapporo office market

NRA

As of May 2017, the total NRA available in Sapporo's five major office districts amounted to 507,000 tsubo, a 2.6% increase since 2011. Although the newly-built Sapporo Fukoku Seimei Koshiyama Building opened at full occupancy in January, the area's total NRA has slightly declined due to ongoing redevelopment.

The area has seen a number of office redevelopments in recent years and experienced temporary decreases in office space. Most recently, the Sapporo Daido Seimei Building was demolished in 1H/2017. The owner of the building acquired the adjacent Contactoff Building and plans to build a new office building by fall of 2019 on the block. Moreover, the highly anticipated Sapporo Sosei Square is expected to add a large amount of NRA in March 2018, which should give the extremely tight market some breathing room.

Vacancy

Sapporo's average vacancy rate stands at 3.1% as of May 2017, tightening an additional 1.2ppts YoY. Vacancy has dipped below 2% in three out of five surveyed submarkets.

Demand for call centre space has been increasing. According to the local government, the number of call centre related companies active in the city has grown from 58 to 86 from 2010 to 2016. During the same period, the number of employees in the sector has doubled from 18,200 to 37,700. Further expansion of this sector is likely to absorb planned new supply in the market.

Vacancy in the Odori-koen area stands at a record low of 1.7% despite the newly-completed Sapporo Fukoku Seimei Koshiyama Building, indicating strong demand in the submarket. Tenant relocations from the Sapporo Daido Seimei Building and the Contactoff Building also likely contributed to the vacancy decline.

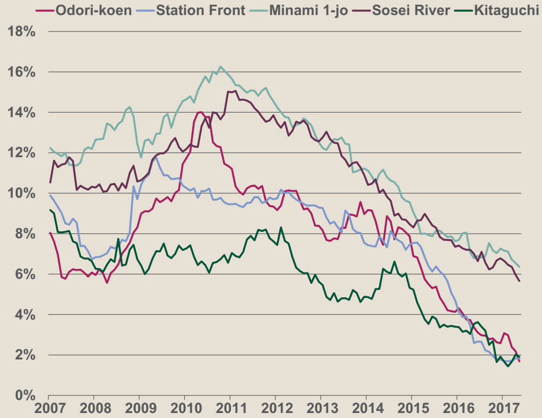
Rent

Rental growth in Sapporo has accelerated since late 2016. In April, Sapporo's average rent climbed 2.0% YoY, the biggest YoY increase since before the financial crisis. In May, the market continued to be up 1.8% YoY.

Strong rental growth has been visible especially in submarkets with low vacancy. Odori–koen has experienced the biggest and fastest rental increase, followed by the Kitaguchi and Station Front areas. Rents in Odori-koen rose by 3.7% YoY as of May. Although rents remain lowest in the Sosei River and Minami 1-jo areas, tightening vacancy in the

GRAPH 18

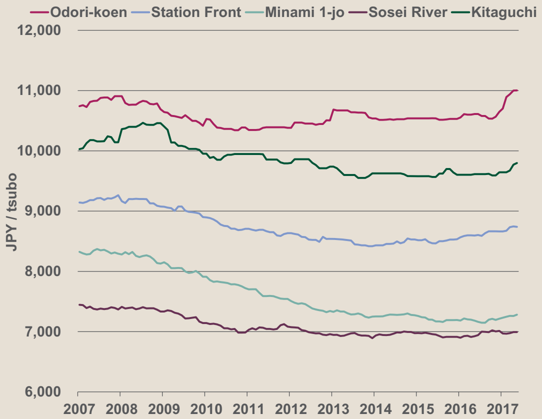
All-grade vacancy rate in Sapporo by area, 2007–May 2017



Source: Miki Shoji, Savills Research & Consultancy

GRAPH 19

All-grade average rent in Sapporo by area, 2007–May 2017



Source: Miki Shoji, Savills Research & Consultancy

TABLE 10

Hokkaido prefecture key macro indicators*

	Japan	Tokyo	Hokkaido
Real GDP (JPY trillion)	525.2	100.7	**18.5**
% of Japan	100%	19%	**4%**
Population (thousands)	126,740	13,726	**5,352**
Job to applicant ratio	1.5	2.1	**1.1**

Source: Cabinet Office, Hokkaido Prefectural Government, Savills Research & Consultancy
* Real GDPs for Japan, Tokyo, and Hokkaido are for Q1/2017, 2016, and 2014 respectively.

Sapporo (con't)

Sapporo market overall has also improved rents in these areas.

Outlook

Due to historically limited supply and strengthening demand, Sapporo's occupancy conditions have been strong. The average vacancy in main business areas is nearing 3%, and three submarkets are dipping below 2%, reflecting strengthening underlying office demand in Sapporo.

However, relatively large supply planned in the next three years may provide some slack for the currently very tight market. Market reaction to the introduction of Sapporo Sousei Square, which is due for completion in March 2018, should indicate how fundamentals will move going forward. If secondary vacancy is not quickly absorbed, rental growth may slow.

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