Japan - July 2021

SPOTLIGHT

Savills Research

Regional Japanese Office Markets

savills

Regional markets have softened, but a turnaround is in sight

Summary

- Investment-grade offices in most markets have seen rents fall and vacancy rates rise, albeit at moderate levels.
- Rental growth in all-grade offices has flattened. Meanwhile, vacancy rates have noticeably loosened, though not to the extent seen in Tokyo.
- Affected by the pandemic, investment volumes in 2020 were 9% lower than those of 2019. Similarly, investment flows during Q1/2021 were limited, though this should increase as the economy recovers.
- Japan's economy saw growth in Q4/2020 before contracting slightly in Q1/2021. With the acceleration of the vaccination program, however, a recovery is in sight.
- The pandemic has clearly shifted demographic trends, and as a result, fewer people are moving to central areas than in previous years. The full impact on the office market remains to be seen, however.
- The supply pipeline differs greatly from city to city. While the prospect of substantial supply exists, the presence of weak demand does not bode well for rental growth.

INVESTMENT-GRADE OFFICES[1]

Having had to contend with the global pandemic for over a year, the regional investment-grade office markets have weakened. Conditions surrounding both vacancy and rents have diminished as a result.

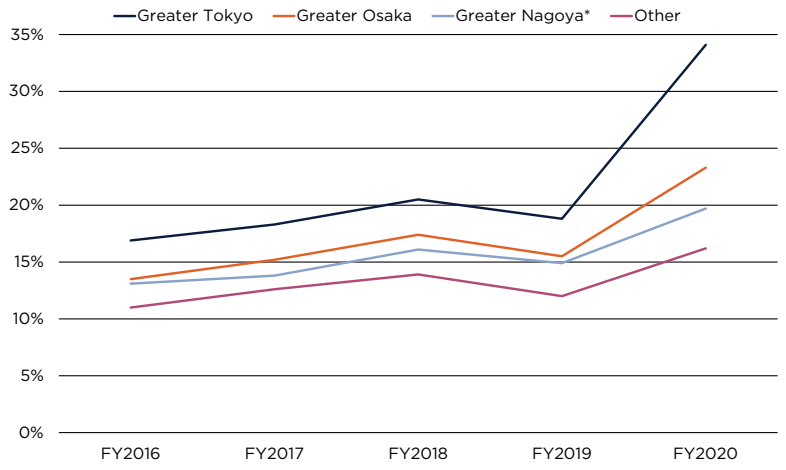
All regions have seen vacancy rates rise to above 1.0%, with Nagoya and the capital exhibiting the largest loosening on an annual basis. Nevertheless, vacancy levels are still below 2.0% in all regions bar Nagoya and overall fundamentals remain sound.

Looking at rents, Fukuoka saw a 1.3% YoY increase, partially boosted by the completion of some modern offices. Other markets were not so fortunate, with rents in Osaka and Nagoya falling by 2.2% and 0.6% YoY, respectively. It is notable, however, that rents in Tokyo plummeted by 6.5%, suggesting that investment-grade offices in regional cities are faring relatively better than the capital.

Looking a bit closer, this market downturn was not even across all the regions. Here, as usual, performance varies greatly depending on office location and quality although the overall changes witnessed in vacancies and rents are generally still at manageable levels. As such, there is hope that the regional office landscape will improve as vaccinations are expedited and the economy fully opens.

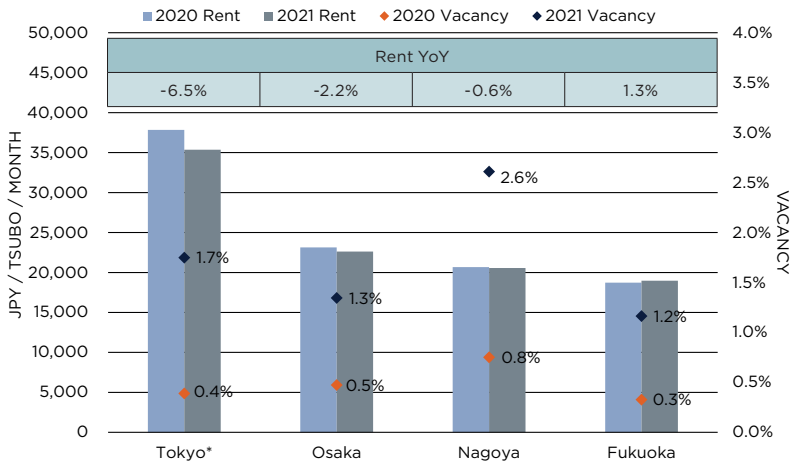
1 In each of Osaka, Nagoya, and Fukuoka, Savills monitors about 50 "investment-grade" office buildings typically with a GFA of 15,000+ sq m (4,500 tsubo) and a building age of <25 years.

GRAPH 1: Remote Work Levels By Region



Source Ministry of Land, Infrastructure, Transport and Tourism, Savills Research & Consultancy
*Greater Nagoya comprises Aichi, Gifu, and Mie prefecture.

GRAPH 2: Investment-grade Office Performance, 1H/2021



Source Savills Research & Consultancy
*Tokyo data represents Grade A office performance in the C5W.

ALL-GRADE OFFICES[2]

As we would expect, with the effects of the pandemic lingering, growth in the all-grade market has cooled. However, the presence of growth in all regions except for Osaka, where rents contracted 0.3% YoY, is a positive development. In this regard, rents in Fukuoka and Sendai saw the greatest gains, rising by 2.5% and 2.4% YoY, respectively.

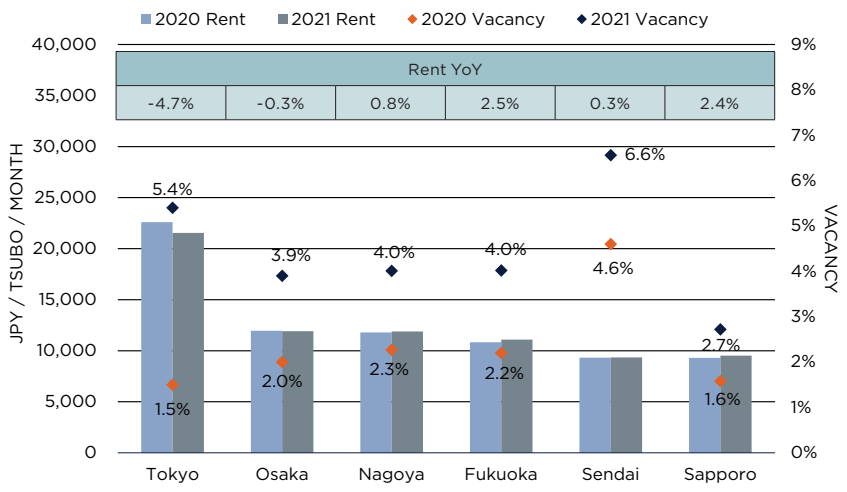
Meanwhile, vacancy rates have inched up across all regional markets. Sapporo exhibited the smallest expansion of 1.1 percentage points (ppts) YoY, while Sendai saw the largest of 2.0ppts YoY.

However, when compared to the loosening of 3.9ppts YoY in Tokyo, the relative vacancy movements in regional cities appear moderate.

2 "All-grade" refers to offices typically over 1,000 sq m GFA, depending on the market. Data is sourced from Miki Shoji.

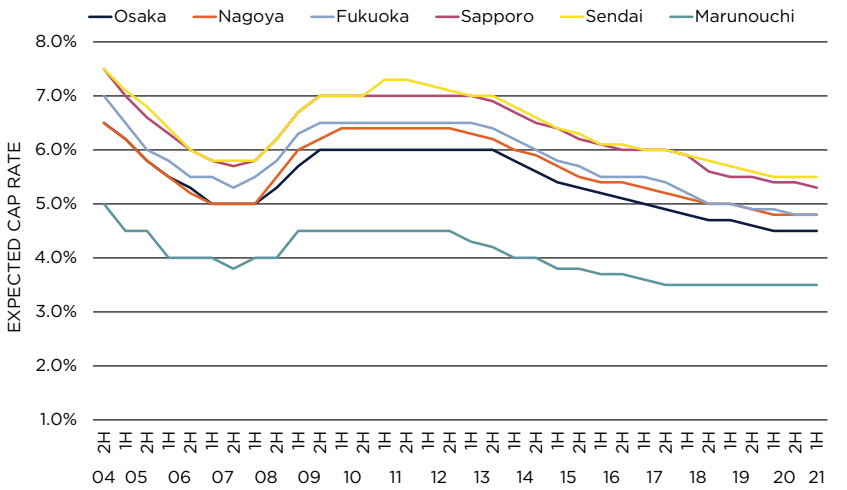
COVID-19 has taken its toll on regional markets, with many seeing weakening rents and rising vacancy. That said, the expedited vaccination rollout should help spark an economic recovery later this year and increase demand for office space. For now, the prospects for each region will depend on demand and supply fundamentals.

GRAPH 3: All-grade Office Performance, 1H/2021*



Source Miki Shoji, Savills Research & Consultancy
*Market data as of Mar 2020 and Mar 2021

GRAPH 4: Expected Cap Rates for Grade A Offices, 2004 to 1H/2021



Source Japan Real Estate Institute, Savills Research & Consultancy

Unsurprisingly, regional markets have not been immune from the impact of the pandemic. For starters, poor economic conditions have led to the closure of many small and medium enterprises – tenants commonly seen in such markets. Furthermore, the proliferation of flexible work arrangements has meant that some companies now require less office space than before. Consolidations and cancellations of relocations to larger floor plates have followed.

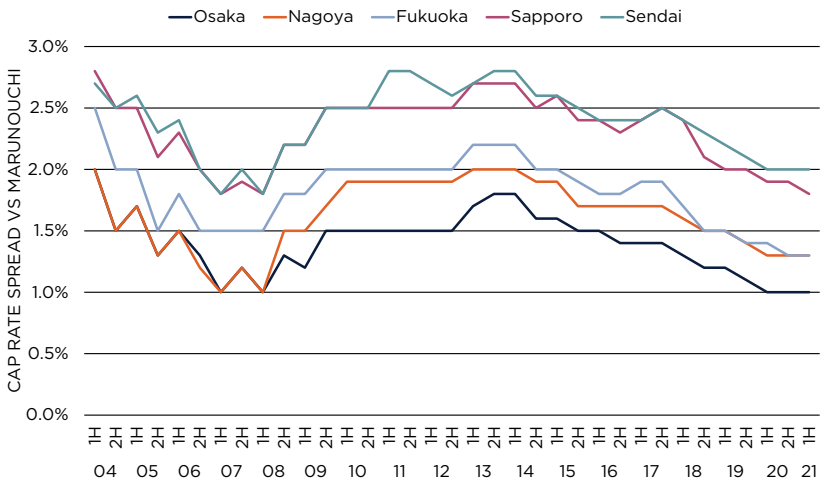
Despite the circumstances, regional offices have weathered the pandemic fairly well, particularly compared to the capital. One reason for this could be the difference in the level of remote work between the two. According to a study undertaken by the Ministry of Land, Infrastructure, Transport and Tourism (MLIT), remote work has been significantly more prominent in Greater Tokyo since the pandemic began (Graph 1). This is most likely to be due to the capital's longer commute times and urban density. With this in mind, given their higher utilisation rates, regional office markets should prove more stable going forward.

REGIONAL INVESTMENT

According to the bi-annual investor survey conducted by the Japan Real Estate Institute (JREI) in April 2021, cap rates in all regional markets have remained flat, with the exception of Sapporo which tightened 10 basis points (bps) from the previous half-year. Overall, this indicates that interest in the market has remained strong amidst the pandemic because of its stability as well as the attractive funding options available.

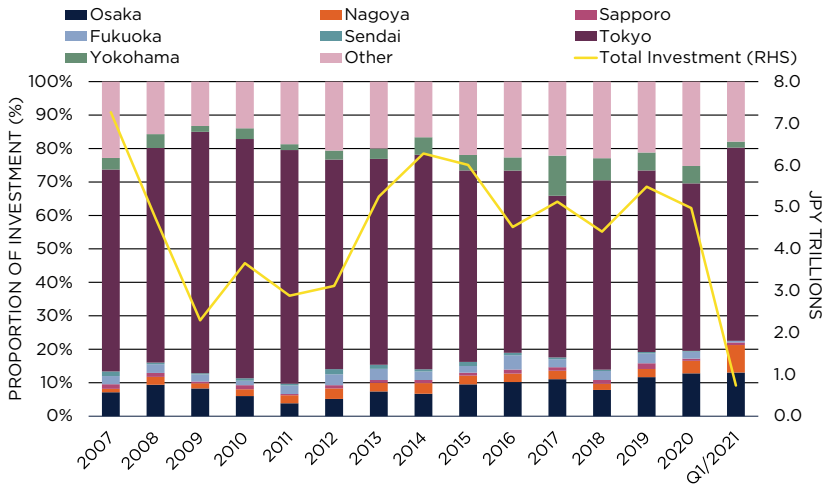
In light of the pandemic, investment volumes in 2020 declined 9% YoY, although they were still higher than 2018 levels. Specifically, within the office sector, transactions fell 13% YoY to its lowest annual

GRAPH 5: Expected Cap Rate Spreads (vs Marunouchi), 2004 to 1H/2021



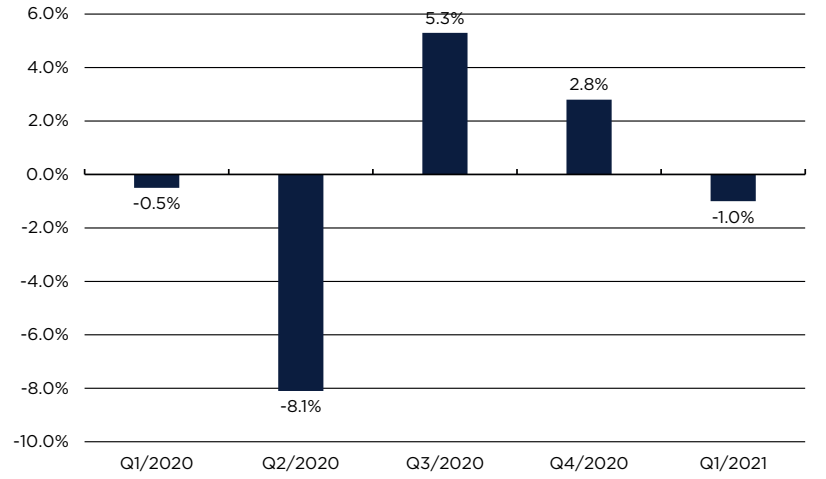
Source Japan Real Estate Institute, Savills Research & Consultancy

GRAPH 6: Investment Volumes By Area For All Asset Types, 2007 to Q1/2021



Source RCA, Savills Research & Consultancy
*Transactions where specific locations have not been identified are classified as other.

GRAPH 7: Japan Real GDP Change QoQ, Q1/2020 – Q1/2021*



Source Cabinet Office, Savills Research & Consultancy
*Data is based on the second preliminary forecast

investment volume since 2012. Indeed, more widespread remote work conditions had led to uncertainty over occupier demand for offices, and subsequently supressed investor appetite towards the sector. Nonetheless, as the pandemic fades into the background and workers return, expectations of rental recoveries have driven some confidence back into the sector. This should translate to an increase in investment volumes in 2021.

There are still high levels of both domestic and international investor interest. As an example, after announcing its plans to invest US$10 billion in Japan over the next two to three years, with up to a 70% allocation to office buildings, BentallGreenOak acquired Hirokoji Cross Tower in Nagoya in a transaction estimated to be in the higher end of the JPY40 billion range. Furthermore, PAG also acquired Shin-Yokohama Business Tower for an estimated JPY16 billion. Despite a slow first quarter, higher transaction volumes can be expected over the remainder of 2021 as the pandemic approaches a close and market prospects become clearer.

REGIONAL MACRO AND DEMOGRAPHICS

After a significant decline in GDP in Q2/2020 resulting from the economic slowdown induced by the pandemic, Japan saw two quarters of positive real GDP growth in the latter half of 2020. In Q1 this year, real GDP was reported to have contracted slightly by 1.0% QoQ, following a second state of emergency declared in January. Despite the extended restrictions into Q2, the Bank of Japan's (BOJ) Regional Economic Report in April 2021 adopted a neutral outlook on the economies of most regions, with the exception of Hokkaido and Tohoku whose economies were hit harder by the pandemic. Indeed, the Japanese economy may look forward to a slow but steady recovery, which will accelerate as the pace of vaccinations picks up.

The job-to-applicant ratio has seen little change since the pandemic hit, with levels in the prefectures which we cover hovering above 1.0x over the past half-year, with the exception of Hokkaido which has dipped slightly below that level. Nonetheless, considering that the ratios in Hokkaido were well below 1.0x up till 2015, the employment environment is still in relatively good shape. Overall, the fact that a majority of regions have a ratio over 1.0x is comforting, although the relatively weaker employment may delay the increase in demand for office space.

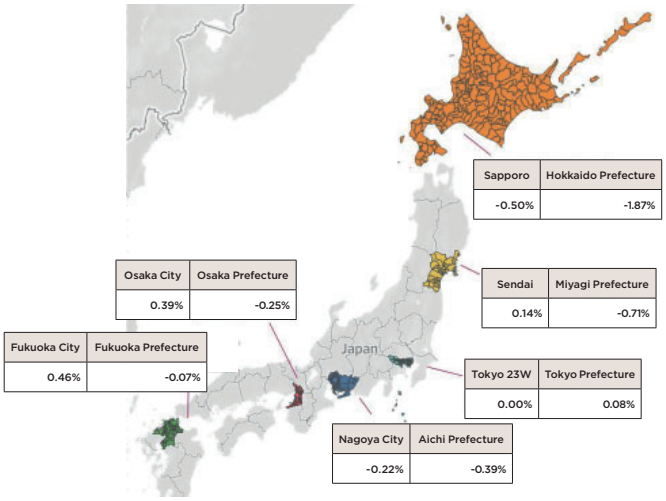
Elsewhere, the pandemic has shifted demographic trends in some cities. Notably, cities like Sapporo and Nagoya saw falls in their populations from pre-pandemic times, deviating from their usual upward trend.

TABLE 1: BOJ Regional Economic Assessment, April 2021

REGION	TREND	CHANGE VS JAN 2021
Hokkaido (Sapporo)	"The economy has remained in a severe situation due to the impact of COVID-19, and has been more or less flat."	↘
Tohoku (Sendai)	"The economy has picked up as a trend, but the impact of a resurgence of COVID-19 appears to be growing recently, primarily in consumption of services."	↘
Kanto (Tokyo)	"The economy has picked up as a trend, although it has remained in a severe situation, primarily in consumption of services."	→
Tokai (Nagoya)	"The economy has been picking up, even during the continued severe situation."	→
Kinki (Osaka)	"The economy has been picking up on the whole, although it has remained in a severe situation due to the impact of COVID-19. However, consumption of services has been facing strong downward pressure, with the implementation of priority measures to prevent the spread of disease."	→
Kyushu (Fukuoka)	"The economy has started to pick up, primarily in exports and production, although it has been in a severe situation."	→

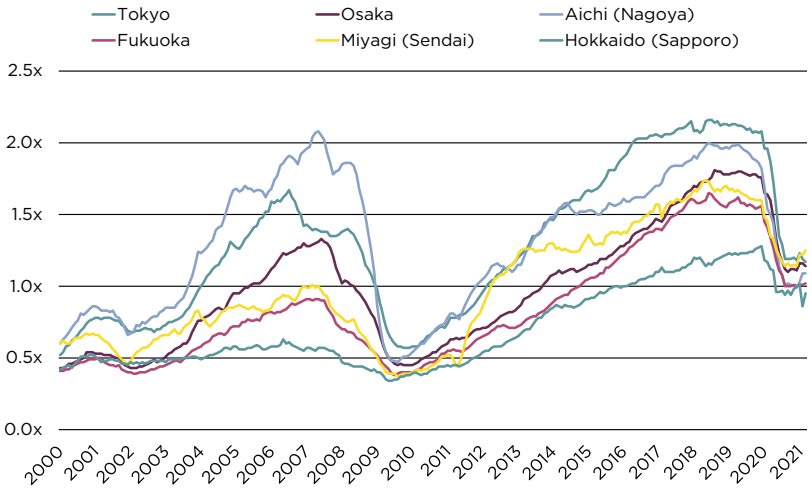
Source Bank of Japan, Savills Research & Consultancy

MAP 1: Population changes in selected prefectures and cities, January 2020 to May 2021*



Source Respective Prefectural Governments, Savills Research & Consultancy
*Fukuoka's population change is between Jan 2020 and Sep 2020, as the prefecture paused its population census.

GRAPH 8: Job-to-applicant Ratios, Selected Prefectures, 2000 to March 2021



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

Although the impact of workstyle changes is being felt more in Tokyo, increased remote working appears to have reduced the propensity to move to more central locations in many areas. In the long term, despite the low risk of these cities losing their importance as key hubs for commerce, these migration trends might be prolonged if companies continue to embrace remote working practices. Many companies may instead adopt a hybrid work style, giving staff the opportunity to occasionally work remotely, but with the office still functioning as its main operational base.

OUTLOOK

More than a year has elapsed since the pandemic struck. While companies have adapted well to the circumstances, fluctuating infection cases have made it difficult for occupiers to assess the economic situation and as a result many have taken a wait-and-see approach regarding leasing new office space.

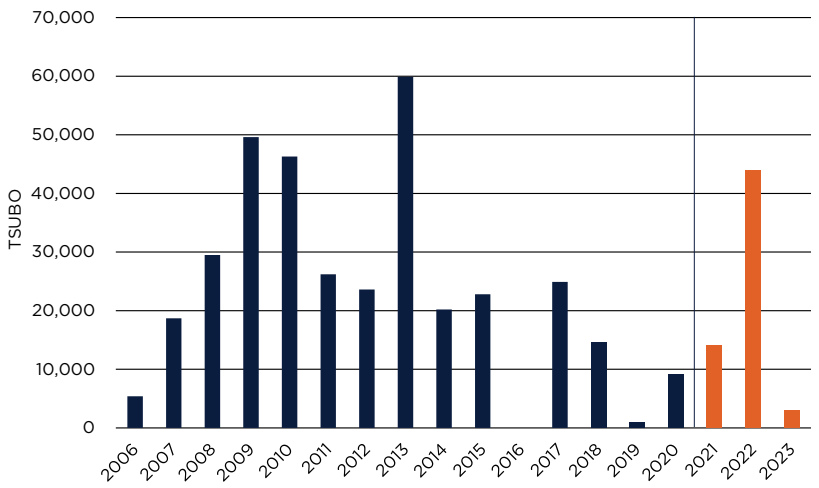
Remote work has undoubtedly become more widespread in Japan, partly contributing to some loosening in office vacancy levels across all regions. In the case of all-grade offices, however, the relatively lower levels of remote working in regional areas have led these offices to perform better than Tokyo.

Additionally, progress in vaccinations has allowed us to envision a post-pandemic world. Less convenient offices may see some corrections in rent in order to attract tenants as some companies are likely to adjust their leasing strategies and prioritise better located offices.

Furthermore, investment-grade offices have maintained low vacancy rates despite the pandemic and have proved to be quite resilient. Looking forward, older offices with poor accessibility have a higher chance of suffering in the mid-term due to more prolific flexible work arrangements.

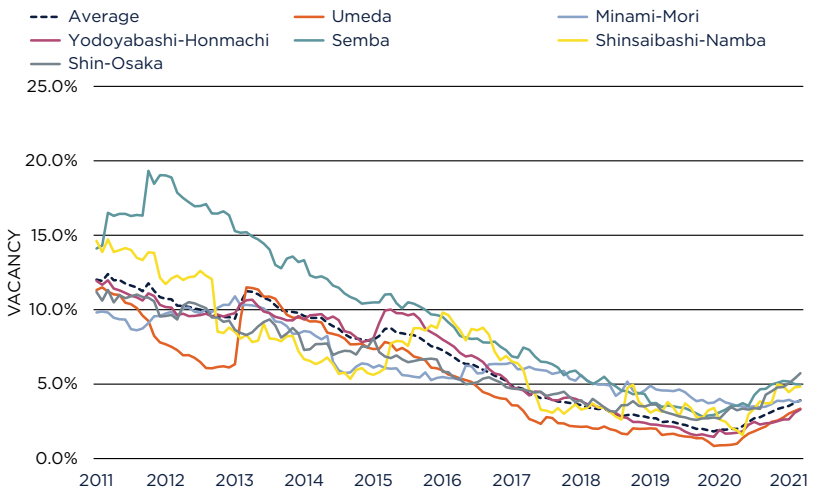
One market which may struggle is Osaka. Here we expect the delivery of large amounts of office supply concentrated within a few areas in a short period of time. This, matched with discouraging pre-leasing does not bode well for the market. Furthermore, like Tokyo, it has seen comparatively heightened levels of flexible work arrangements, reducing demand for offices.

GRAPH 9: New NRA Office Supply In Osaka City, 2006 to 2023



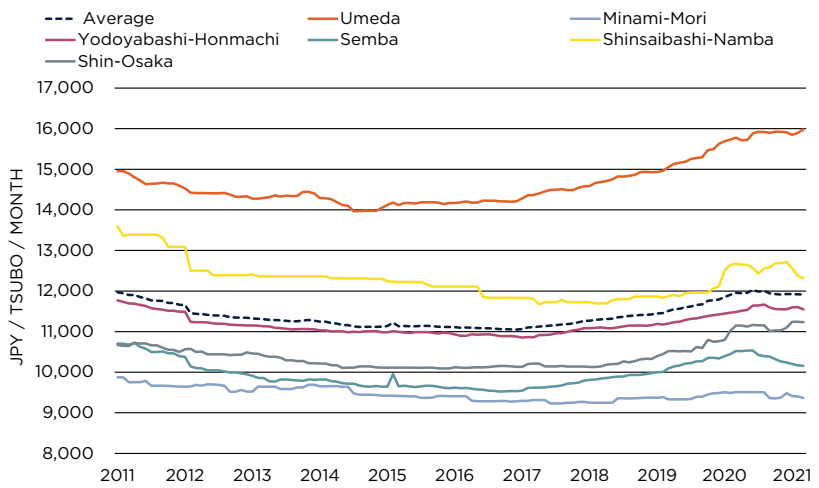
Source Sanko Estate, Building Group, Savills Research & Consultancy

GRAPH 10: Vacancy Rate In Osaka City By Area, 2011 to Q1/2021



Source Miki Shoji, Savills Research & Consultancy

GRAPH 11: Average Rent In Osaka City By Area, 2011 to Q1/2021



Source Miki Shoji, Savills Research & Consultancy

OSAKA CITY

Net Rentable Area (NRA)

New supply in Osaka looks to be unevenly distributed over the coming years. While supply in 2021 and 2023 is relatively sparse, 2022 and 2024 look to add around 45,000 and 65,000 tsubo of NRA, respectively.

2021's most notable completion, the Honmachi Sankei Building, is adding about 9,000 tsubo of NRA to the market. While pre-leasing for new buildings this year has been poor, the impact of this will likely be moderate given its size.

The Osaka Umeda Twin Towers South will lead the supply throughout 2022, introducing 28,400 tsubo of high-quality NRA into the Umeda submarket, and has had sound pre-leasing activity. Likewise, another large property coming to the market next year, the Nippon Life Yodoyabashi Building, also appears stable. However, 2024 also looks to add over 60,000 tsubo of additional NRA into Umeda, and it is uncertain if the submarket will be ready to absorb such a large amount.

Vacancy

Investment-grade vacancy rates have increased 0.9ppts YoY to 1.4%. A sizable portion of this is attributed to the S-Building Shin-Osaka that came to the market in late 2020 and remains mostly vacant in part due to its nonideal location.

All-grade vacancy rates have been gradually increasing since the onset of the pandemic, with a particular uptick in Shin-Osaka. Many new buildings in this submarket have been sitting at low occupancy, evidently the underlying contributor to the high vacancy levels seen in the city.

Given the limited new supply expected in 2021 and sound pre-leasing activity for supply in 2022, alongside a slowdown in COVID-19 cases, the Osaka office market should be able to perform better.

Rent

Rents for investment-grade offices in Osaka have decreased 2.2% YoY, and overall, the gains seen in the previous year have effectively been reversed. Indeed, some buildings experiencing vacancies have reduced rents in order to quickly attract new tenants.

After growing throughout the pandemic, rental growth in the all-grade office market has finally petered out. Specifically, Semba and Shinsaibashi have shown contractions of around 3.0% YoY from the highs seen in 2020. However, thanks to continued growth in Umeda and Shin-Osaka, rents in Osaka overall only declined 0.3% YoY to JPY11,900 per tsubo.

Despite the contraction seen over the past year, rental levels are currently overall higher than they were two years

TABLE 2: Osaka Prefecture Key Macro Indicators

	TOKYO	OSAKA
Real GDP (JPY trillion) (FY2018)	105.9	39.0
Real GDP (YoY%)	0.5%	0.1%
% of Japan (FY2018)	19%	7%
Population (million)	14.0	8.8
Job to applicant ratio	1.2	1.2

Source Cabinet Office, Osaka Prefectural Government, Savills Research & Consultancy

TABLE 3: Osaka Investment-grade Offices

	1H/2021	HOH	YOY
Rent	22,600	-2.0%	-2.2%
Vacancy	1.3%	+0.8ppts	+0.9ppts
Top Rent	35,000	0	0

Source Savills Research & Consultancy

ago. Furthermore, rents for investment-grade offices in Osaka are over 30% more expensive than they were five years ago in 2016, demonstrating robust growth. However, this high rate of growth has conversely made corrections in rental levels more likely with the economy weakened.

Umeda

Umeda is still the most expensive submarket in Osaka. Specifically, the range of investment-grade rents is still between JPY20,000 and JPY35,000 per tsubo, having remained unchanged largely through the pandemic. While there have been some patches of vacancy arising in a few buildings, vacancy levels are generally tight.

A large amount of supply will enter the market in 2022, namely the Umeda Twin Towers South and the Nippon Life Yodoyabashi Building. With rumours of large corporations moving into these buildings, secondary vacancy is certain to arise in some buildings located around Umeda and Nakanoshima.

Yodoyabashi-Honmachi

The Yodoyabashi-Honmachi submarket has overall managed to maintain its rental levels. In general, most investment-grade offices are demonstrating low levels of vacancy, although there are a few exceptions.

For instance, the OBIC Midosuji Building is still showing high levels of vacancy since it came onto the market in early 2020, in part due to its relatively high rental levels. Indeed, some other offices coming to the market this year have had poor pre-leasing activity and are decreasing rents in order to quickly attract tenants.

Shin-Osaka

Shin-Osaka's rents have seen softening although its range of rents have remained unchanged from the previous half-year. However, the levels of asking rents for new buildings have decreased significantly since pre-pandemic times. Furthermore, many buildings are starting to exhibit notable levels of vacancy, showing the stark contrast between popular buildings and less popular ones.

For instance, the pre-leasing activity for new buildings set to open in early 2022 are looking poor with few tenants decided despite their approaching completion. As such, the submarket should see further weakening.

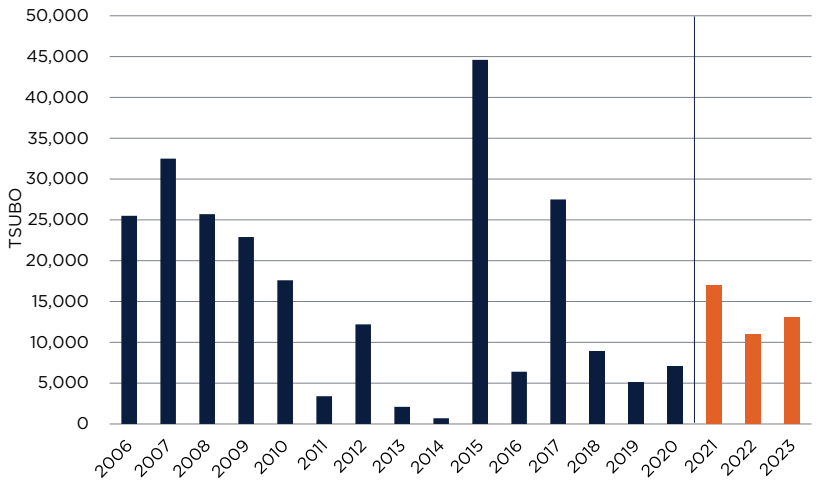
Outlook

Compared to a half year ago, on the surface, market conditions in Osaka look somewhat bleak - vacancy levels have increased, rents have declined, and the restrictions on business hours from the state of emergency have added further downward pressure on consumption. Furthermore, the low levels of inbound tourism have weakened the local economy. This has greatly affected the land value of commercial prime areas, which has decreased by over 20% since the onset of the pandemic.

The new supply in 2021 has seen poor levels of pre-leasing. As such, it may take additional time before the supply can be amply filled. Furthermore, Osaka's substantial supply in 2022 and the resulting secondary vacancy is a concern. Areas like Shin-Osaka are likely to suffer more from the supply because of the robust growth seen in previous years and its distance from Osaka's CBD.

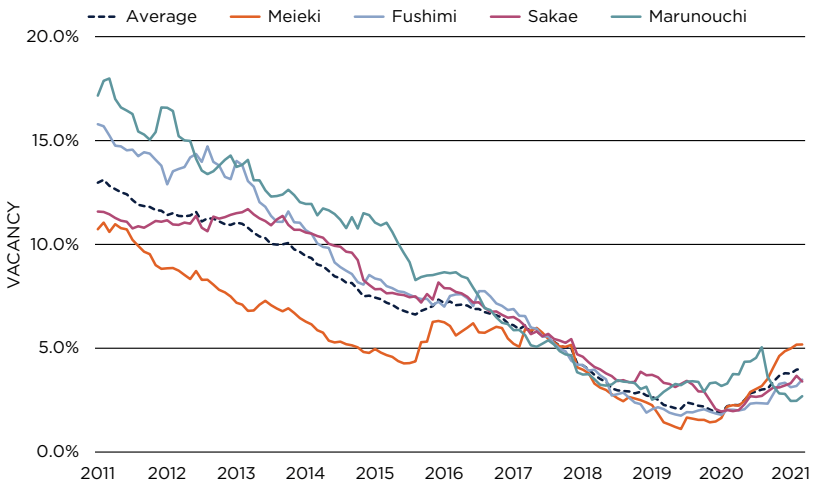
Nonetheless, while the Osaka market has seen some softening, there is still hope for the market going forward. The Osaka market should improve once the Tokyo office market gets back on track with the overall improving economic conditions next year.

GRAPH 12: New NRA Office Supply In Nagoya City, 2006 to 2023



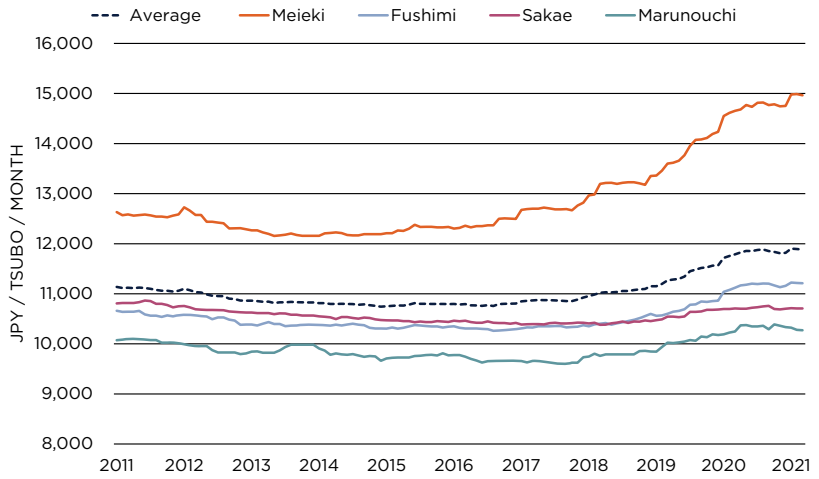
Source Sanko Estate, Biz Life Agent, Savills Research & Consultancy

GRAPH 13: Vacancy Rate In Nagoya City By Area, 2011 to Q1/2021



Source Miki Shoji, Savills Research & Consultancy

GRAPH 14: Average Rent In Nagoya City By Area, 2011 to Q1/2021



Source Miki Shoji, Savills Research & Consultancy

NAGOYA CITY

NRA

After three consecutive years of relatively low supply, Nagoya looks to introduce a steady supply of NRA into the market towards 2024 comprising multiple large projects that are well distributed across different submarkets.

In 2021, about 17,000 tsubo of NRA will be added to the market. The largest supply influx will come from the mixed-use project BIZrium Nagoya, bringing 7,000 tsubo of NRA. However, response to the development so far has been varied given its unique features. Elsewhere, buildings near Nagoya station have continued to perform well. For instance, the Nagoya Mitsui Building North, having introduced over 5,000 tsubo of NRA at the start of this year, is making an acceptable start.

Pre-leasing activity in upcoming developments like the Urbannet Nagoya Nexta building in 2022 is doing well, with a majority of the building already filled. Further down the pipeline, the Chunichi Building set to open in 2023 looks promising, and has plans to start pre-leasing activity with reasonable asking rents.

Overall, the stable pace of new supply in Nagoya in upcoming years should not distort the market's balance of supply and demand and should be well received given current response to new buildings coming online, and the overall performance of most investment-grade buildings.

Vacancy

The global pandemic has persisted for over a year and has taken its toll on the Nagoya economy. To wit, investment-grade offices have seen an increase in vacancy by 1.8ppts to 2.6% YoY. However, a significant portion of the increase came from Global Gate West Tower and the Meieki Daiya Meitetsu Building that both lie away from Nagoya station. In contrast, most other buildings are either at full occupancy or minimal vacancy.

Average vacancy levels have risen to 4.0% for the all-grade market and have been gradually increasing since the start of the pandemic. Meieki is the primary source of the market's high vacancy levels, having reached 5.0% vacancy in March 2021.

Going forward, secondary vacancies are likely to arise in older buildings as a result as newer buildings are completed. However, moderate rental corrections accompanied with the recovering economy should maintain sufficient demand for these office buildings.

Rent

Investment-grade rents have seen a mild decline of about 0.6% YoY to approximately

TABLE 4: Aichi Prefecture Key Macro Indicators

	TOKYO	AICHI
Real GDP (JPY trillion) (FY2018)	105.9	39.4
Real GDP (YoY%)	0.5%	1.9%
% of Japan (FY2018)	19%	7%
Population (million)	14.0	7.5
Job to applicant ratio	1.2	1.1

Source Cabinet Office, Aichi Prefectural Government, Savills Research & Consultancy

TABLE 5: Nagoya Investment-grade Offices

	1H/2021	HOH	YOY
Rent	20,600	-0.5%	-0.6%
Vacancy	2.6%	+1.4ppts	+1.8ppts
Top Rent	35,000	0	0

Source Savills Research & Consultancy

JPY20,600 per tsubo. While the pandemic has halted rental growth, the market remains solid overall as seen in the sound pre-leasing activity, suggesting that rents may recover once the economy strengthens.

As vacancy neared 4.0% for the all-grade market, rental growth has begun to fade. While Meieki and Fushimi saw positive rental growth due to newer buildings, Sakae and Marunouchi's rental growth began to flatten out in 2021.

Meieki

Meieki is still the premium submarket with its access to Nagoya station and high-quality buildings. Nonetheless, its rents have contracted 2.6% YoY to around JPY27,800 per tsubo. Indeed, signs of weakening demand have even been seen in the towers around the station - some vacancies have arisen after being fully occupied for a few years. Moreover, its range of rents has stretched to between JPY26,000 and JPY35,000, signifying a drop of JPY2,000 on the lower end.

The lower rental levels have been accompanied by increases in vacancy, particularly in a few buildings. For example, the Nagoya Mitsui North Building came to the market in early 2021 with a few vacant floors.

Fushimi and Marunouchi

Rental levels in Fushimi and Marunouchi have managed to hold firm over the past year despite the economic downturn, with rents still averaging more than JPY18,000 per tsubo. Vacancies in both submarkets are low overall, demonstrating the relatively strong performance of the area.

Hirokoji Cross Tower is currently occupied by Mitsubishi UFJ, that will move to the nearby Mitsubishi UFJ Nagoya Building set to be complete in by mid-2021. Given the building's very large size, it may encounter some difficulty when filling floors without adjusting rents.

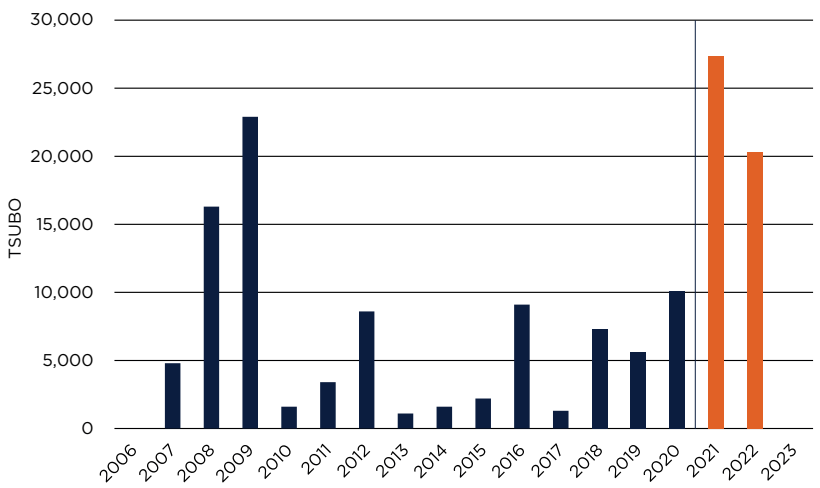
Outlook

Nagoya has seen rental growth flatten with vacancy loosening across the market. While the most prime buildings should perform well, the weakened economy could mean that other buildings will have to lower rents in order to attract tenants. Nonetheless, the market looks to be in good condition.

Overall, new supply in Nagoya seems to be of good quality and well distributed across different locations, and therefore is expected to be positively received by the market.

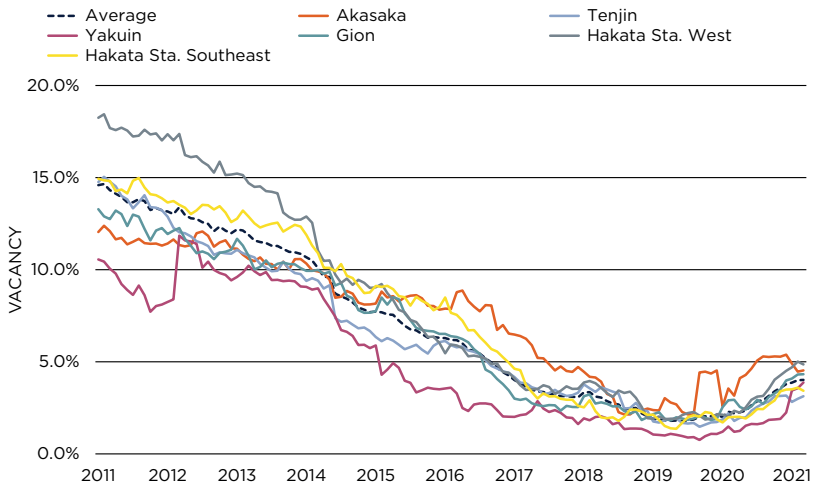
Post-pandemic, the strong manufacturing sector should boost GDP growth for the city as the worldwide economy recovers and demand for manufactured goods increases.

GRAPH 15: New NRA Office Supply In Fukuoka City, 2006 to 2023



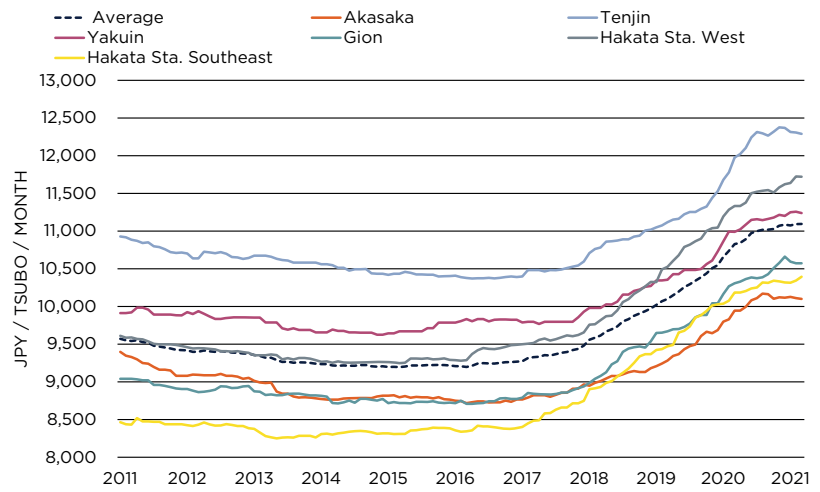
Source Sanko Estate, Building Group, Savills Research & Consultancy

GRAPH 16: Vacancy Rate In Fukuoka City By Area, 2011 to Q1/2021



Source Miki Shoji, Savills Research & Consultancy

GRAPH 17: Average Rent In Fukuoka City By Area, 2011 to Q1/2021



Source Miki Shoji, Savills Research & Consultancy

FUKUOKA CITY

NRA

In late 2020, office stock in Fukuoka saw a drop in NRA to its lowest point in recent years. However, a new high is expected by the end of 2021 with the largest amount of new supply in over a decade due to come to the market. Furthermore, supply is expected to continue increasing in 2022 before cooling down in 2023.

Overall, the market reaction to the new supply in 2021 has been positive, and it has been mostly absorbed. However, 2022 will also introduce over 20,000 tsubo of NRA, approximately four times the average amount introduced between 2011 and 2020. Considering that a majority of the supply in 2022 will be built away from train stations, these properties may encounter some difficulty in attracting tenants.

After a reprieve in 2023, developments such as the Fukuoka Building Block Redevelopment Project, which is the main part of the Tenjin Project, are expected to add 12,000 tsubo of NRA in 2024. Moving forward to 2028, projects such as Tenjin Big Bang and Hakata Connects are expected to add substantial levels of supply.

Vacancy

For the first time in five years, the vacancy levels of investment-grade buildings in Fukuoka have exceeded 1% after increasing 0.8ppts YoY. The root of the increased vacancy was COVID-19 causing many small to mid-size companies to close or reduce in size, consequently reducing the demand for office space. Many large buildings that were once full are hence beginning to see some vacancy. Moreover, secondary vacancy from the 2020 supply, in combination with a deflated reaction to the 2022 supply thus far, may indicate caution in the market next year.

Specifically, Yakuin saw the highest increase in vacancy in 1H/2021, rising 2.7% YoY. On the other hand, Tenjin and Akasaka saw decreases in vacancy by a few percentage points from last year. The remaining submarkets stayed relatively flat.

Elsewhere, the all-grade market in Fukuoka has nearly doubled in vacancy YoY to 4.0%. With many mid-sized buildings continuing to see departures, vacancy levels have continued to increase.

Rent

In 1H/2021, investment-grade rents in Fukuoka increased by 0.7% HoH to JPY19,000 per tsubo, partially stemming from a new addition, the Hakata Fukami Park Building. However, despite COVID-19, Fukuoka rental levels have maintained steady growth, primarily due to new office openings and a positive ratio of business openings to closings. Furthermore, the

TABLE 6: Fukuoka Prefecture Key Macro Indicators

	TOKYO	FUKUOKA
Real GDP (JPY trillion) (FY2018	105.9	19.1
Real GDP (YoY%)	0.5%	0.9%
% of Japan (FY2018)	19%	3%
Population (million)	14.0	5.1
Job to applicant ratio	1.2	1.0

Source Cabinet Office, Fukuoka Prefectural Government, Savills Research & Consultancy

TABLE 7: Fukuoka Investment-grade Offices

	1H/2021	HOH	YOY
Rent	19,000	0.7%	1.3%
Vacancy	1.2%	+0.3ppts	+0.8ppts
Top Rent	25,000+	0	0

Source Savills Research & Consultancy

market is beginning to see an increase in leasing activity again after a period of stagnation due to COVID-19.

All-grade rents in Fukuoka increased to JPY11,100 per tsubo in 1H/2021 – the highest price on record. This translates to an increase of 2.4% YoY. Fukuoka's all-grade market has maintained rental growth, whereas many other regional peers have seen growth flatten or slightly contract.

Station Front

The Hakata submarket has remained popular with average rents for investment-grade buildings now at new highs of JPY20,500 per tsubo. In addition, as rental growth has slowed in the most expensive submarket Tenjin, Hakata has narrowed its gap in rents between Tenjin down to 1% – half of the premium seen last year.

New buildings entering the market have been the main drivers of rental growth, and rents remain encouragingly between JPY17,000 and JPY25,000. That said, the new supply also caused a bump in vacancy levels to 2.6%.

Tenjin

After seeing a 4.5% increase in rent from the end of 2019 to the start of 2020, rental growth in Tenjin has slowed as rental levels decreased 0.5% this half-year. Even so, despite the massive influx of supply in 2021, the Tenjin Business Centre, which will introduce over 11,000 tsubo of NRA into the market this year, is currently 80% reserved. Furthermore, its face rent at JPY30,000 per tsubo indicates a promising start.

Vacancy levels in Tenjin have decreased over the past half-year by 0.3ppts to 1.4%. This tight vacancy looks to continue throughout the year, but secondary vacancy remains a concern. Additionally, Daimyo Garden Square, slated for completion in 2022, may find its location disadvantageous.

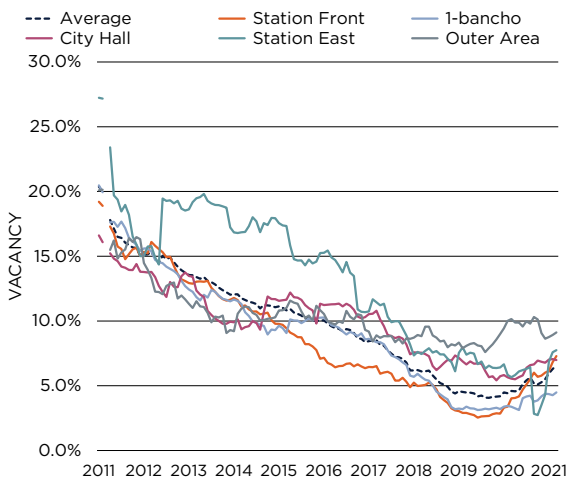
Outlook

Thus far, the Fukuoka office market is holding out well without much deterioration. While it has begun to see vacancy levels inch up, the market remains tight, and rents have been increasing. Furthermore, most of the new supply completed this year has seen strong demand and there have been limited incidences of large-scale cancellations. However, as new supply enters the market throughout the year, secondary vacancy could become an increasing concern.

Given the propensity for tenants to place increasing emphasis on location, the delivery of 20,000 tsubo of NRA in 2022 across three developments in secondary locations may be scrutinised. Indeed, going forward, we expect to see greater polarisation between less convenient buildings and their counterparts which are newer and closer to major stations.

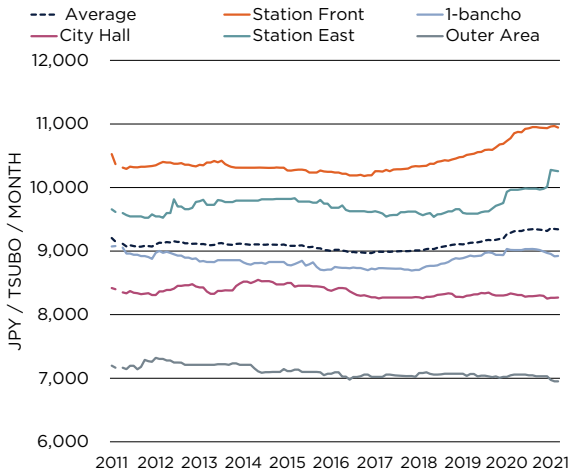
On a brighter note, April 2022 will see a new train line open between Tenjin and Hakata, the two main areas of Fukuoka. This will not only see a much-needed connection between these two areas, but the plans for various new businesses should also bring additional foot traffic downtown. This new train line should aid Fukuoka's central office market and boost its growth potential going forward.

GRAPH 18: Vacancy Rate In Sendai City By Area, 2011 to Q1/2021



Source Miki Shoji, Savills Research & Consultancy

GRAPH 19: Average Rent In Sendai City By Area, 2011 to Q1/2021



Source Miki Shoji, Savills Research & Consultancy

TABLE 8: Miyagi Prefecture Key Macro Indicators

	TOKYO	MIYAGI
Real GDP (JPY trillion) (FY2018)	105.9	9.6
Real GDP (YoY%)	0.5%	0.6%
% of Japan (FY2018)	19%	2%
Population (million)	14.0	2.3
Job to applicant ratio	1.2	1.2

Source Cabinet Office, Miyagi Prefectural Government, Savills Research & Consultancy

SENDAI CITY

Supply and Demand

This year, Sendai will see the largest influx of NRA since 2012. This will be followed by two years of manageable supply before another large influx in 2024 driven by the NTT Sendai Chuo Building, which will add over 6,000 tsubo of NRA. This injection of supply will help curb the trend of decreasing NRA in the city and help freshen Sendai's ageing stock. Although, the new supply in 2021 is likely to cause some secondary vacancy, the subsequent two years of low supply should give the market enough time to recover.

In 2020, most of the newly supplied NRA was absorbed by the market, and this trend has continued in 2021. For instance, the JR Sendai East Building will contribute nearly 70% of the total NRA this year and appears currently almost fully occupied. Additionally, the Milene T Sendai Building, which makes up over 25% of the NRA for 2021, is almost fully leased. Looking at the encouraging performance of these buildings, new office supply looks set to continue its strong absorption rate.

Vacancy

In response to the pandemic, occupiers have adopted remote work practices, and subsequently cancelling office relocations. These actions have caused vacancy to increase to 6.6% - up 1.1ppts from the end of last year. In fact, vacancy has been creeping higher every month since October 2020. The COVID-19 spikes have discouraged the business expansion of foreign companies as well as other strong sectors, such as Japanese IT and back-office support centres.

All submarkets saw an increase in vacancy in 2021, with Station East posting the highest increase of 2.1ppts YoY to 7.8%. This increase stemmed from the opening of major buildings that brought over 6,000 tsubo of GFA into the submarket, consequentially creating some secondary vacancy. The Station Front submarket may also see some vacancy increases as the Milene T Sendai Building comes onto the market later this year.

Outer Area is the only submarket whose vacancy has continued to stay at pre-COVID levels. The submarkets of 1-bancho and City Hall have begun to see their vacancy rates stabilise. For instance, Sougo Career Group set up its new office in the Sendai Dai-ichi Life Group Building located in 1-bancho in March.

Rent

Despite a loosening in vacancy levels, average rents have generally increased in Sendai. Whilst the new offices completed this year were one factor that contributed to the growth, existing space has also seen increased rents. Overall rents have inched up nearly 0.3% YoY to JPY9,350 per tsubo.

Station East saw its rents increase by 2.9% YoY. However, the submarkets of Outer Area, 1-bancho and City Hall, have seen a decrease in rents at 1.5%, 1.0%, and 0.6% YoY, respectively. This decrease could be primarily attributed to discounts and other incentives to attract tenants.

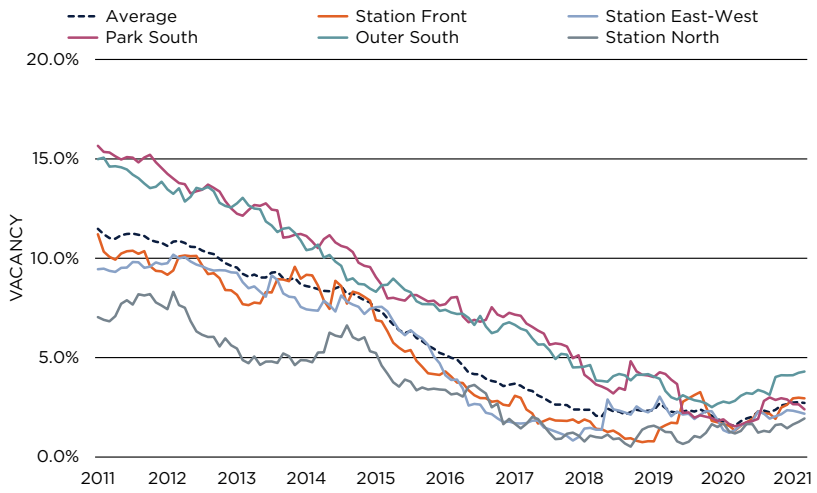
The Station Front submarket remains the most expensive at nearly JPY10,900 per tsubo – over 7% higher than Station East that places second. With rental growth of 0.8% and 2.9% YoY, respectively, these two submarkets contributed to the bulk of the region's performance over the year. At the other end, rents in the Outer Area remain the cheapest at around JPY6,950 per tsubo – a 57.5% discount to Station Front rents.

Outlook

Despite vacancy loosening, rents have continued to increase, albeit marginally, primarily driven by core areas around the main station. At the same time, demand for new buildings is still strong as evident by the notable absorption of new supply. Moving forward, however, the secondary vacancy from recent supply, coupled with the lease cancellations or reductions of SMEs, may continue to drive vacancy up and increase polarisation in the market where the demand for older and less convenient buildings is waning.

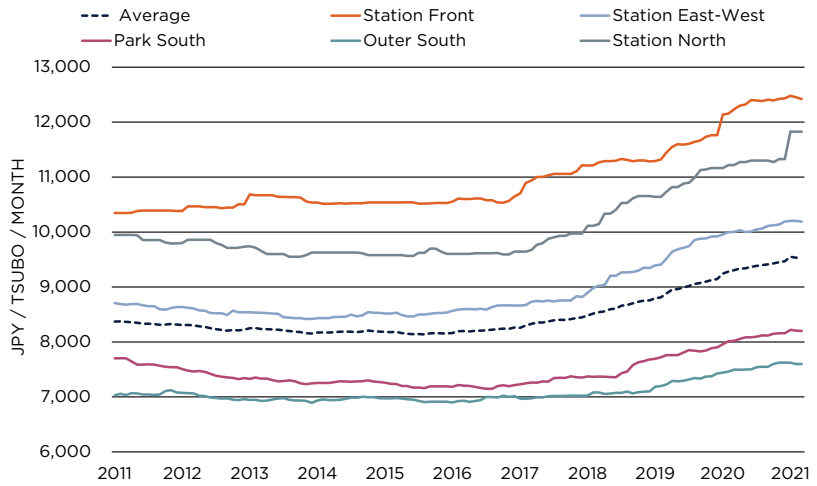
One of the most sweeping issues for Sendai is its shrinking population. Miyagi is expected to see an estimated 8% decline in the population between 2015 and 2025 – the largest drop when compared to other major regions. However, Sendai has several high-level educational institutions, such as Tohoku University which hosts Nobel laureates, and will hopefully produce a steady flow of young professionals who will stay in Sendai and help boost the local economy.

GRAPH 20: Vacancy Rate In Sapporo City By Area, 2011 to Q1/2021



Source Miki Shoji, Savills Research & Consultancy

GRAPH 21: Average Rent In Sapporo City By Area, 2011 to Q1/2021



Source Miki Shoji, Savills Research & Consultancy

SAPPORO CITY

Supply and Demand

2021 will see a large increase in GFA of nearly 7,000 tsubo with a steady stream expected in the years to follow. Demand for office space in Sapporo has persisted despite the large amount of NRA introduced to the market in 2021. Specifically, vacancies have managed to remain under 3%.

New buildings in recent years have seen strong absorption by the market. Despite some large cancellations, demand from call centres and technology companies has eased any vacancy increments. One example would be the new S-Building that had seven of its ten floors taken up by TMJ, a company that offers call centre and other back-office support services. They plan on hiring another 700 people in the short term. This pattern of demand looks set to continue as new buildings such as The Peak Sapporo, which is due to come online this year, has had sound interest so far.

Vacancy

While the average all-grade vacancy rate for Sapporo has been slowly rising since March 2020, concurrent with the onset of COVID-19, the vacancy rate has flattened out at 2.7% for the fifth month in a row.

The flattening vacancy rate has been aided by improved demand in the primary Station Front submarket as well as the more affordable submarkets of Park South and Station East-West. We may see this tested later this year with GFA of nearly 7,000 tsubo slated to come onto the market.

TABLE 9: Hokkaido Prefecture Key Macro Indicators

	TOKYO	HOKKAIDO
Real GDP (JPY trillion) (FY2018)	105.9	19.7
Real GDP (YoY%)	0.5%	0.6%
% of Japan (FY2018)	19%	4%
Population (million)	14.0	5.2
Job to applicant ratio	1.2	0.9

Source Cabinet Office, Hokkaido Prefectural Government, Savills Research & Consultancy

Rent

Rents have increased YoY across all submarkets by 2.4% with the average rent sitting at JPY9,500 per tsubo in Q1/2021. Indeed, Sapporo has continued to keep rents above pre-financial crisis, supported by the opening of new offices with higher rents driving growth in the market. Notably, rents for existing space improved as well.

Rents in the Station Front submarket remain the highest in this region at around JPY12,450 per tsubo with rental growth at 1.5% YoY. Rental growth has also been noticeable in other submarkets. Specifically, all-grade rents in Station North saw an increase of 5.4% YoY, primarily driven by the contracting vacancies and increased competition in the large buildings segment. Park South also saw an increase of 1.9% YoY, thanks in part to the opening of S-Building Sapporo.

Outlook

Despite COVID-19, vacancy remains tight, and rents have continued to rise. Demand has held up well for large buildings with newer infrastructure. Given the steady supply due to come online in the coming years, vacancy is expected to remain tight while rents increase.

However, due to the multiple states of emergencies, office demand has struggled to pick up pace as tenants have sat on the side lines. However, given that infection rates have subsided and that plans for an accelerated vaccine distribution are afoot, we expect the situation to improve moving forward.

Multiple redevelopment projects are underway by Sapporo Station in the central part of the city which will come online over the next few years. These projects will hopefully be boosted by the new bullet train line which will connect Sapporo to other major cities by 2030.

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