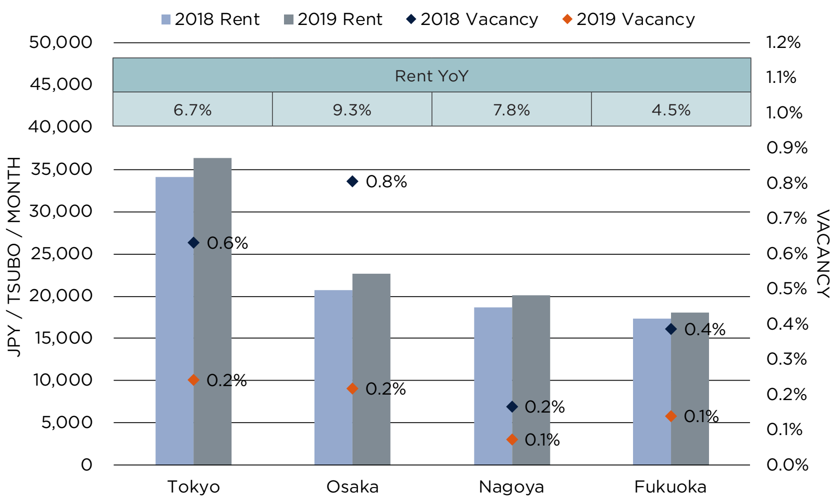
Japan - November 2019

SPOTLIGHT
Savills Research

Regional Japanese Office Markets

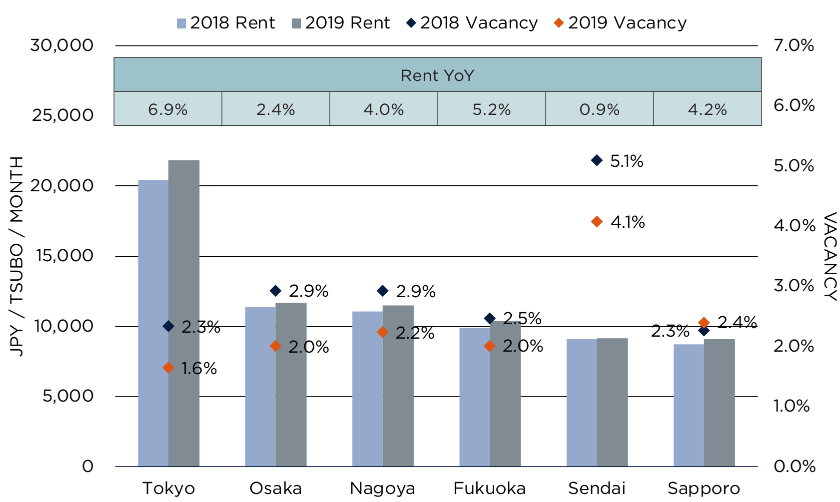
Regional rental growth remains robust, albeit moderating

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



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

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



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

HIGH-GRADE OFFICES[1]

The pace of high-grade rental growth has been strong, though it has moderated compared to the previous period. Rental growth, nonetheless, remains buttressed by extremely tight vacancy rates. That said, top rents may soon start to test the financial limits of tenants.

Each of the three major regions have air-tight vacancy rates, with some having close to no availability at all. Osaka has witnessed the greatest tightening this period, falling 0.6 percentage points (ppts) year-on-year (YoY) to 0.2%. Rates in Nagoya remained fairly unchanged, though this is not surprising given vacancy has been below 0.5% since 1H/2018. Fukuoka follows a similar trend, with vacancy holding firm at 0.1% this year (Graph 1).

High-grade rental growth in Tokyo no longer lags its regional counterparts, outpacing Fukuoka in 2H/2019. In fact, Tokyo was the sole market to experience higher YoY growth compared to the previous period. As a result, the spread between the top performer, namely Osaka, is narrowing.

ALL-GRADE OFFICES[2]

Underpinned by tight vacancy rates, rents in most regions have surpassed previous peaks seen in 2008. Osaka and Sendai are the exceptions, though both are not far off. The relative affordability of this market, given the spread in rents versus the high-grade market, suggests there may be some room for further growth.

As of September, apart from Sendai, average vacancy rates across the regions sit below 2.5%. In Sendai, the vacancy rate lies just above 4% – the lowest level recorded since 1992.

Given the current low levels of vacancy experienced in the submarkets, it is perhaps unsurprising that the pace of tightening has slowed, and in some regions, rates have somewhat loosened YoY – Sapporo being case in point. Regardless, the tight market conditions across the regions has fed through to rental growth. As of September, all regions experienced a pick-up in rents over the year, perhaps spurred by more expensive rents in the high-grade office market. Fukuoka maintains the top spot, growing 5.2% YoY. Nagoya, however, saw the greatest change, with growth doubling to 4.0% YoY compared to September 2018. In contrast, having consistently exceeded 1% of YoY growth since September 2018, rental growth in Sendai has fallen just below that level a year later.

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

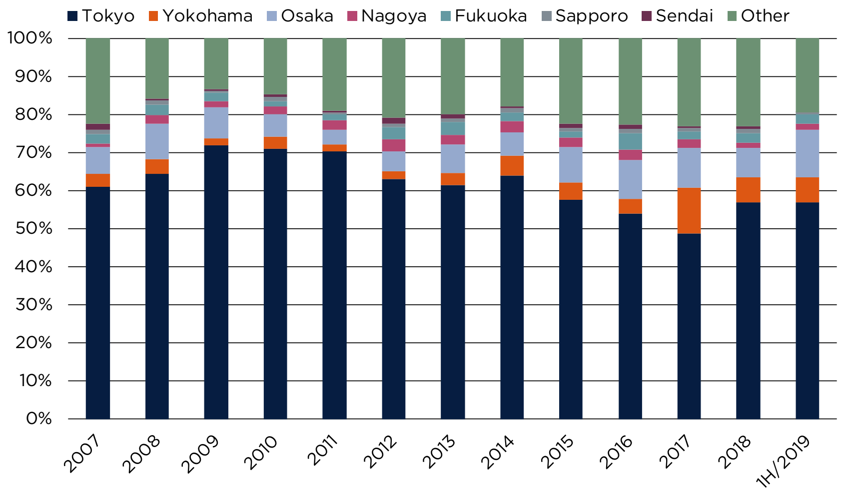
REGIONAL INVESTMENT

Investor sentiment remains positive. According to the bi-annual investor survey conducted by the Japan Real Estate Institute (JREI) in April 2019, cap rates in most submarkets over the year tightened somewhat, including in Tokyo. Similar to the previous report, Fukuoka saw the greatest tightening, compressing by 0.4ppts. Other regions exhibited contractions of around 0.2ppts.

Total real estate investment volumes for 1H/2019 were around JPY2.1 trillion, according to data from Real Capital Analytics (RCA), broadly in line with the same period last year (Graph 3).

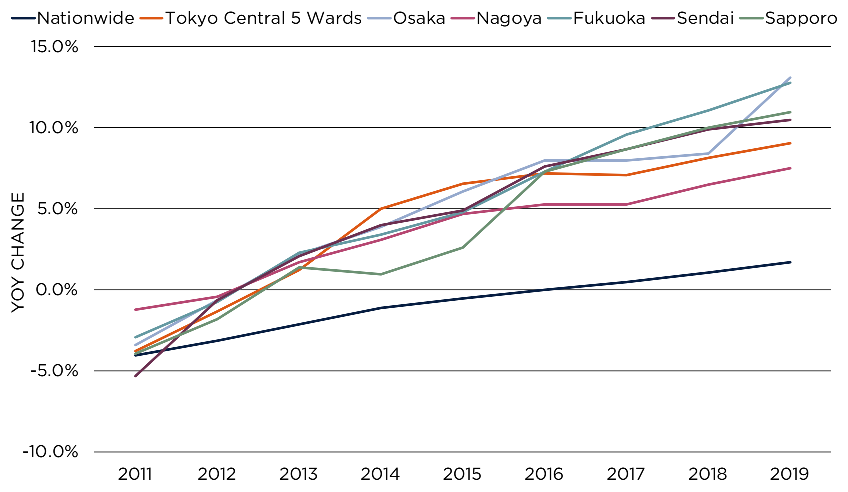
Most regional office markets have demonstrated strong rental growth driven by extremely tight market conditions. This trend should continue going forward, though the rate of growth could slow.

GRAPH 3: Investment Volumes By Area For All Asset Types, 2007 to 1H/2019



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

GRAPH 4: Kijun Chika Commercial Land Prices, 2011 to 2019



Source MLIT, Savills Research & Consultancy

When looking at the regional markets specifically discussed in this report, the variation in office investment volumes is stark. Investment in 1H/2019 has tripled compared to the same period last year, with Osaka experiencing the largest outlay. Overall, this is also true across most other sectors, with Osaka again attracting the lion's share of investment volumes.

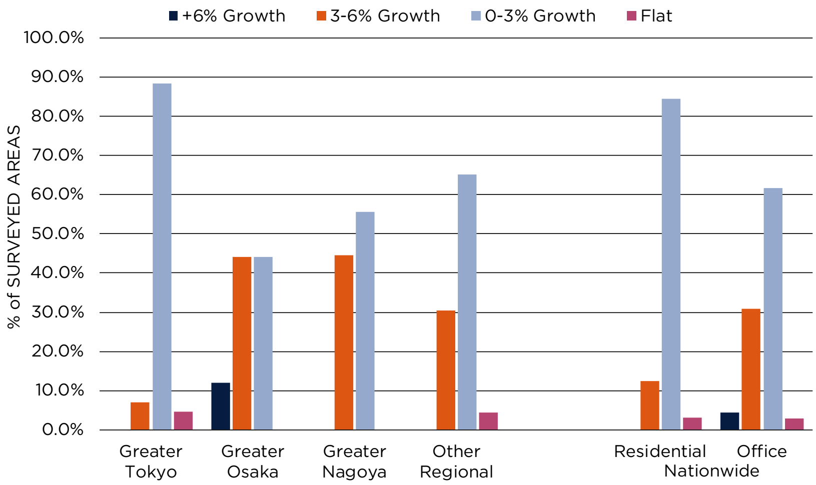
REGIONAL LAND PRICES RISING

According to the most recent national land survey (Kijun Chika), land price growth in the key regions significantly outpaced the national average (Graph 4). Having led performance in 2017 and 2018, Fukuoka, this year, was surpassed by Osaka following the region's substantial growth. The former grew 12.8% – the second consecutive year of double-digit YoY growth – while the latter saw land prices increase by 13.1%. Over the long term, however, Fukuoka is still in the vanguard, with land prices rising by over 57% since 2010. In contrast, average land prices nationwide declined by around 7% over the same period.

Sapporo, having witnessed a fall in land prices between 2010 and 2015, rebounded drastically, recording YoY gains of over 7% every year since. Annual gains in 2019 were 11.0%. Tokyo has, once again, demonstrated solid growth. The capital's importance to the economy continues to underpin investment, which significantly outstrips that of other regions.

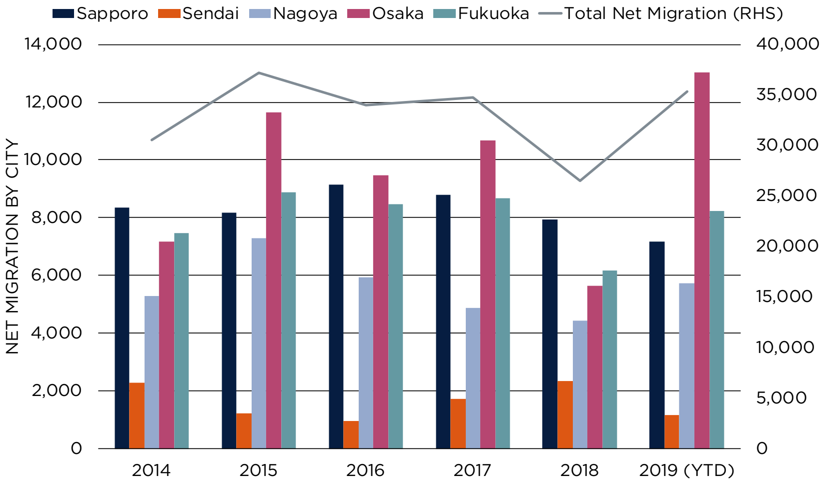
The Ministry of Land, Infrastructure, Transport and Tourism's (MLIT) latest quarterly Land Price Look Report, which tracks the value of 100 "high-use" sites throughout the country, revealed that 97 target sites showed land price increases in Q2/2019. When broken down by region, Tokyo trailed its peers, with Osaka impressing again. Furthermore, according to the report, price growth of land used for offices outpaced residential land, with some sites increasing by more than 6% (Graph 5).

GRAPH 5: Land Price Look Report, Q2/2019



Source MLIT, Savills Research & Consultancy

GRAPH 6: Net Migration For Major Regional Cities, 2014 to 2019YTD*



* Market data as of August 2019.
Source Ministry of Internal Affairs and Communications, Savills Research & Consultancy

TABLE 1: BOJ Regional Economic Assessment, July 2019

REGION	TREND	CHANGE VS APRIL
Hokkaido (Sapporo)	"Recovering moderately"	➡
Tohoku (Sendai)	"Continued to recover moderately, although some weakness has been observed in part"	➡
Kanto (Tokyo)	"Expanding moderately, although exports and production have been affected by the slowdown in overseas economies"	➡
Tokai (Nagoya)	"Expanding"	➡
Kinki (Osaka)	"Continued to expand moderately, although some weakness has been observed in part"	➡
Kyushu (Fukuoka)	"Expanding moderately"	➡

Source Bank of Japan, Savills Research & Consultancy

REGIONAL MACRO

In its Regional Economic Assessment in July, the Bank of Japan (BOJ) observed that most regional economies were on a moderate path of growth, though acknowledged the need for caution going forward (Table 1). Sentiment for the Tokai region (Nagoya), however, appears to be more bullish compared to its peers.

A shrinking population in concert with demographic headwinds remains a national concern. The regional cities covered in this report, however, given their economic importance, are relatively insulated by population challenges as evidenced by continued positive net migration (Graph 6). The biggest beneficiary as of August this year has been Osaka, followed by Fukuoka. Despite being only part way through the year, the former has seen positive net migration more than double compared to last year's total.

Over the longer term, Fukuoka is the sole region to have forecasted population growth between 2015 and 2035 (Graph 7), with an increase of 9% anticipated. Sendai, in contrast, is predicted to experience the largest decline in population over the same period, falling by around 6%.

EMPLOYMENT AND DEMAND

Having continued its downward trajectory from the previous period, the national unemployment rate hit a low of 2.2% in July – the lowest level since October 1992. From August to September, however, the trend lost steam and increased slightly to 2.4%.

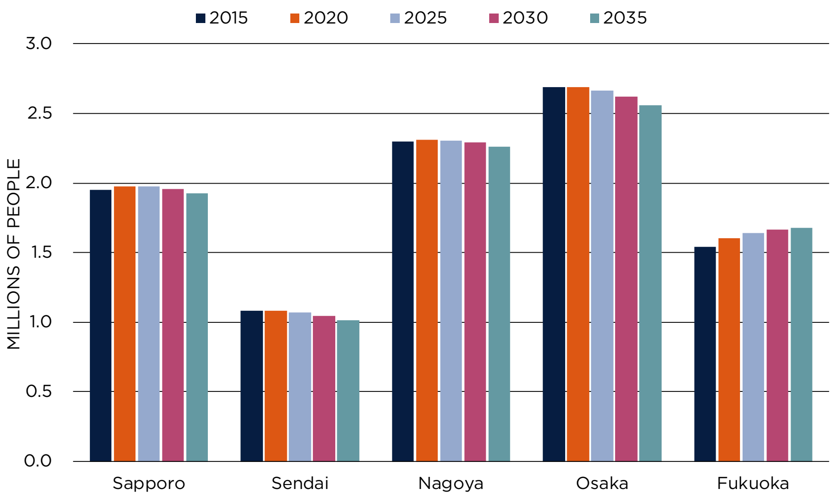
The national job-to-application ratio, having reached a high of 1.64x in September 2018, slowly declined to 1.57x over the next 12 months (Graph 8). Despite remaining highly competitive, the decline in the ratio perhaps suggests a somewhat stabilisation of the labour market.

CHANGING CORPORATE CONDITIONS

As expected, given its importance to the global economy, Tokyo is home to a significant share of the country's largest corporations. This means that the tenant pool for the regional office market is predominantly made up of branch offices and small- and medium -sized companies.

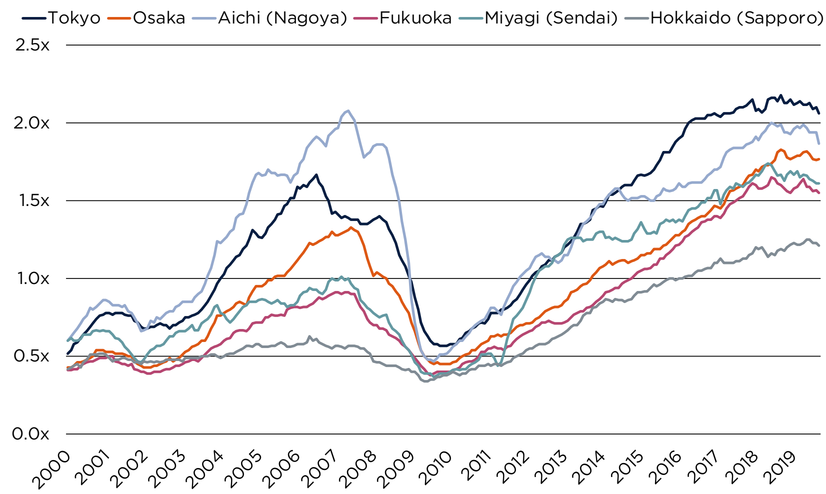
From Q2/2016 to Q1/2019, the divergence between average profits for large companies and small- and medium-size companies widened to its biggest spread (Graph 9). Yet, this trend seems to have reversed in Q2/2019. Amid global economic uncertainty and ongoing trade disputes, profits of larger businesses, with greater international exposure, stuttered. Profits for small- and medium-size companies, in contrast,

GRAPH 7: Population Forecasts For Major Regional Cities, 2015 to 2035



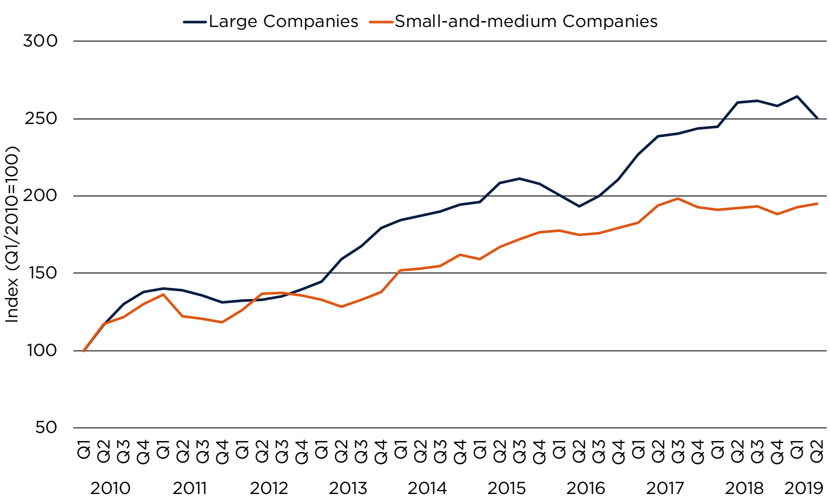
Source National Institute of Population and Social Security Research, Savills Research & Consultancy

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



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

GRAPH 9: Four-period Moving Average For Profits Of Small- and Medium-sized* And Large-sized Companies, Q1/2010 to Q2/2019



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

experienced a slight recovery from the dip witnessed in mid-2017.

If the ongoing trade disputes continue to weigh on larger-company profits, especially in the manufacturing industry, these businesses may find high-grade rents challenging. Therefore, we could potentially see these businesses transitioning towards cheaper properties. In addition, the market segment for these more affordable offices could benefit further from the improving financial capabilities of smaller businesses looking to expand. In an already tight market then, the added competition should, therefore, support rent growth across the affordable end of the market.

Although the underlying fundamentals appear to support continued rental growth, it is worth considering the vulnerability of small- and medium -sized companies when the economy is in a downturn. It is therefore encouraging to see that corporate profits for these companies are over 35% higher than 2008-peaks, suggesting that they should have some more dry powder when an economic recession does occur.

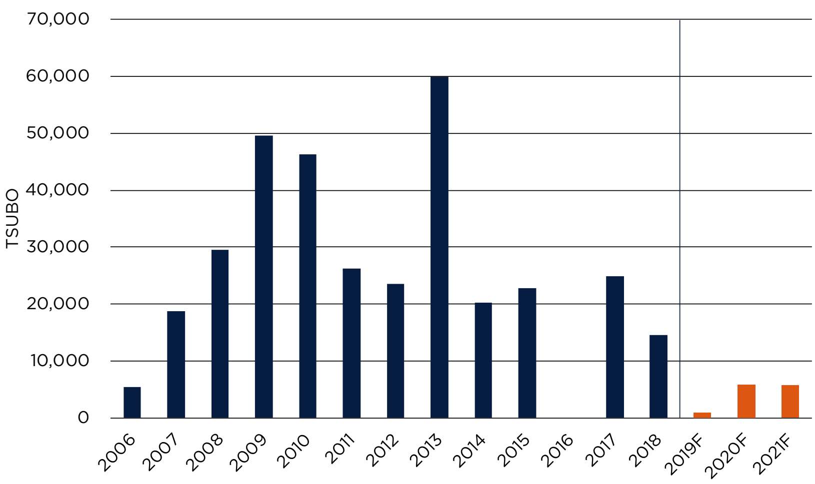
OUTLOOK

Until now, regional office markets have been underpinned by favourable market conditions, especially on the supply side. This has subsequently supported solid rental growth in both the high-grade and all-grade markets, with many submarkets in the latter recently surpassing peaks set in 2008. This positive momentum is expected to mostly continue in the all-grade market as supply is slow to adjust. For high-grade offices, however, despite performing remarkably well, affordability is starting to be tested, especially at the top end of the market. As a result, similar to what is currently being observed in Tokyo, the upside for rents in this submarket may be somewhat limited.

Although there has been some recovery of average profits of small- and medium -sized companies, economic uncertainties abound. The vulnerability of these smaller companies is higher than that of larger companies, and the risk from the recent consumption tax hike in October 2019 is yet to be fully understood. Furthermore, despite the domestic bias, these businesses are by no means immune to the effects of ongoing international trade disputes, and any deterioration of market conditions could trickle down to the regional office market.

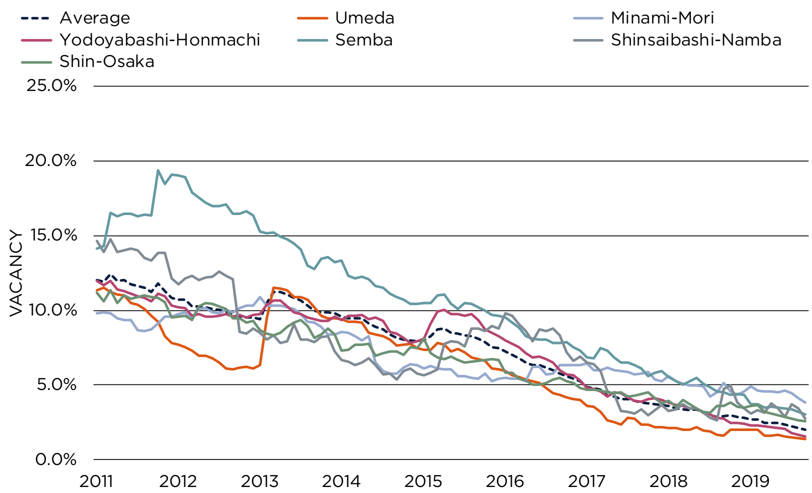
Nonetheless, corporate profits comfortably exceed 2008-peaks, and therefore, businesses should be able to weather economic uncertainty for the time being. Indeed, Japan's political and economic stability stands out within the current global turmoil.

GRAPH 10: New NRA Office Supply In Osaka City, 2006 to 2021



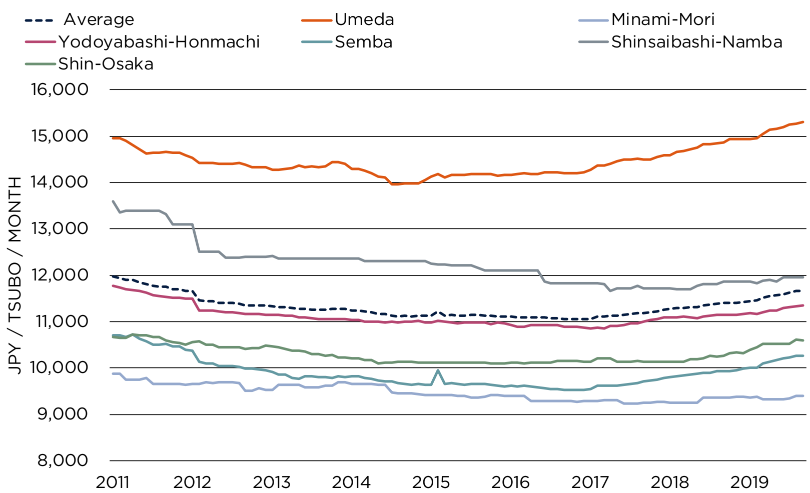
Source Sanko Estate, Savills Research & Consultancy

GRAPH 11: Vacancy Rate In Osaka City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

GRAPH 12: Average Rent In Osaka City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

OSAKA CITY

Net Rentable Area (NRA)

Since March 2019, Osaka's total NRA has been slowly falling below 2.2 million tsubo, the combination of a decline in building numbers and lack of additional supply being the key drivers.

Additional supply in Umeda – Osaka's top submarket – is not anticipated until 2022. This is expected to noticeably change around 2024, however, with the Umekita phase two projected to add significant supply, easing the pressure somewhat.

Vacancy

Since the last report, average high-grade vacancy has remained at 0.2%. All-grade vacancy for Osaka's CBD, on the other hand, has continued its downward trend, falling 0.9ppts YoY to 2.0%, as of September.

Office supply in Osaka is extremely tight, and this theme is likely to continue for the time being. For instance, the Umeda Twin Towers South Building, due to be completed in 2022, has already reportedly pre-leased for multiple tenants including a main tenant with over 3,000 tsubo, despite asking rents of up to JPY38,000 per tsubo.

Rent

Following an increase of 9.3% YoY, average high-grade office rents in Osaka have risen to JPY22,642 per tsubo per month. The main drivers of this growth, namely Shin-Osaka and Umeda, significantly outperformed their regional brethren, both experiencing double-digit YoY increases for a fourth consecutive period. In contrast, Honmachi was the only submarket to experience no change over the year.

All-grade rents in Osaka, as of September, have reached the highest levels since the end of 2011, growing 2.4% YoY to JPY11,670 per tsubo. The pace of growth, having slowed at the start of the year, has recently improved. Semba was the standout performer, growing 3.4% YoY. Minami-Mori, on the other hand, barely changed over the same period.

Umeda

High-grade rents in this submarket still range from JPY20,000 to JPY35,000 per tsubo per month. Mid-market rents, on the other hand, have continued their upward path. Annual growth for 2H/2019 stands at 11.1%, pushing rents to JPY27,438 per tsubo per month – the highest in the submarket. Vacancy rates are now practically nil following a 0.4ppts decline YoY.

It appears that the recent issues faced by WeWork have not deterred them from expanding their presence in Osaka. The co-working company is reportedly looking

TABLE 2: Osaka Prefecture Key Macro Indicators*

	JAPAN	TOKYO	OSAKA
Real GDP (JPY trillion)	534.3	103.6	38.6
Real GDP (YoY%)	1.3	1.8	1.5
% of Japan (2015)	100%	20%	7%
Population (million)	126.2	13.9	8.8
Job to applicant ratio	1.6	2.1	1.8

Source Cabinet Office, Osaka Prefectural Government, Savills Research & Consultancy
* Real GDP for Japan is as of Q2/2019, for Tokyo, Osaka and % of Japan, 2015.

TABLE 3: Osaka High-grade Office

	2H/2019	HOH	YOY
Rent	22,600	1.4%	9.3%
Vacancy	0.2%	0.0ppts	-0.6ppts
Top Rent	35,000+	0	0

Source Savills Research & Consultancy

to lease 500 tsubo on the bottom floor of the recently completed Yodobashi Umeda Tower later this year.

Yodoyabashi-Honmachi

The lower bound within this submarket moved JPY1,000 higher to JPY14,000. The upper bound held firm at JPY28,000 per tsubo per month. Though vacancy remains close to nil, average rents in this submarket have not changed for the third period in a row. As a result, having had a slight premium over average high-grade rents in H2/2018, monthly rents now sit at a discount at JPY21,333.

The Obic Midosuji Building, slated to be completed in early 2020, has reportedly filled half of its capacity, with advertised rents around JPY25,000 per tsubo per month.

Shin-Osaka

The vacancy rate in Shin-Osaka compared to the other submarkets is high, at 1.3%, after increasing 0.3ppts YoY. The near 10% vacancy in the Shin-Osaka Trust Tower is the main culprit, largely as a result of the bullish rents demanded. Nonetheless, average rents have risen to JPY21,625 per tsubo per month, owing to a near 16% YoY increase. As a result, both the lower and upper bounds grew by JPY1,000 compared to the previous period, now lying between JPY17,000 and JPY28,000.

Samty is planning to construct the Samty Shin-Osaka Building, due for completion in late 2020. The expected floorplate is 217 tsubo, while rents of JPY25,000 per tsubo per month have been reported.

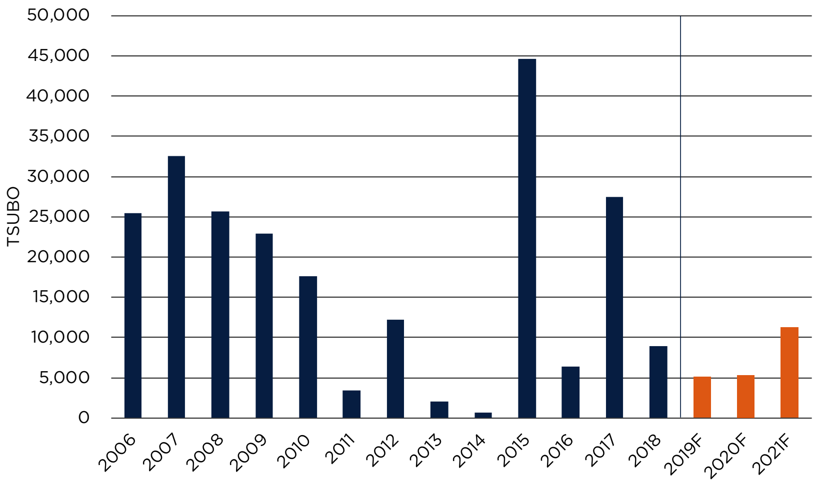
Outlook

The tightness of the market, with additional supply not expected until 2022, coupled with solid pre-leasing, is expected to keep vacancy rates low for the time being. The combination of these two forces should, therefore, be a fillip for the office leasing market over the shorter term. In addition, average all-grade rents remain below 2008 levels suggesting that there should be some upside potential.

Looking further ahead, the World Expo in 2025, a planned integrated resort, as well as related infrastructure improvements, should continue to draw people to the region and be a boon for the local economy.

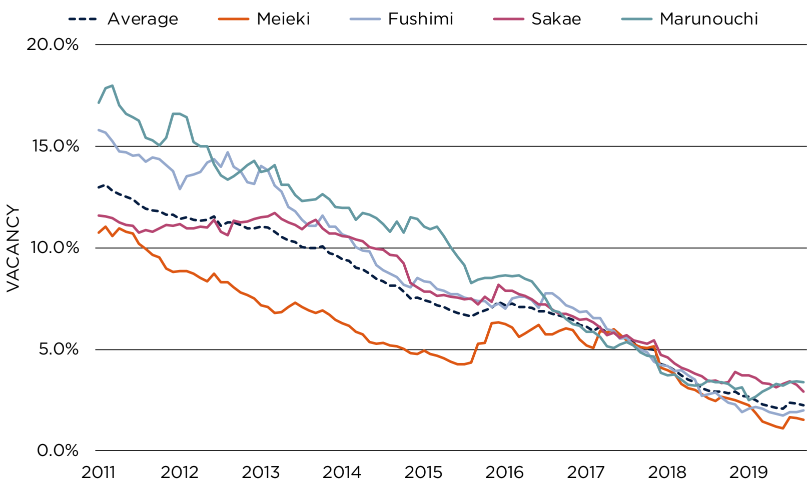
Please refer to our Osaka report, drafted in May 2019, for further information about the region's prospects.

GRAPH 13: New NRA Office Supply In Nagoya City, 2006 to 2021F



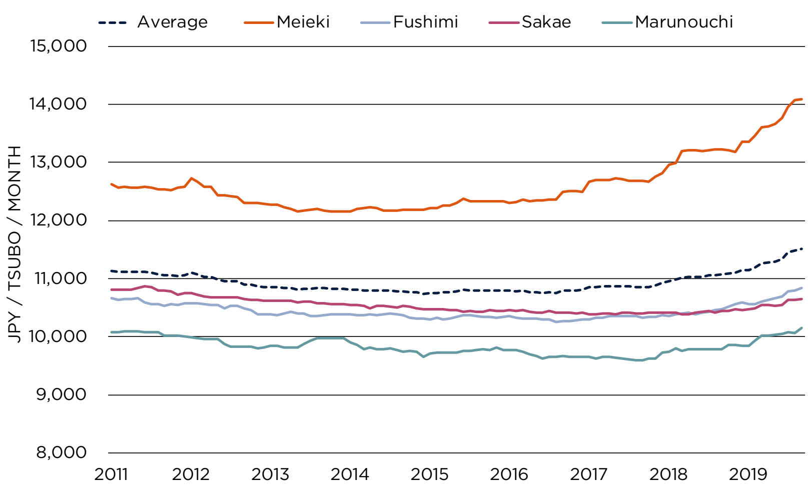
Source Sanko Estate, Biz Life Agent, Savills Research & Consultancy

GRAPH 14: Vacancy Rate In Nagoya City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

GRAPH 15: Average Rent In Nagoya City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

NAGOYA CITY

NRA

Supply in Nagoya is limited. A confluence of drivers, namely the demolition of some buildings and a lack of new projects has kept the NRA below 1.0 million tsubo since early 2018. However, supply conditions should improve slightly as the number of developments pick up.

The K-Square building (formerly the Kajima Fushimi Building), which was completed in September, has been the sole addition to the market this period, bringing some 3,100 tsubo of NRA online. Demand has been sound, with only the first floor currently available.

In the medium term, the largest single project announced thus far is the tentatively named Noritake Forest Project, located north of the Meieki submarket. The multi-purpose complex is expected to be completed in 2021, adding approximately 6,800 tsubo of NRA to the market.

Vacancy

High-grade office supply remains extremely tight with vacancy rates sitting at 0.1%. Though a slight increase from the previous period, where vacancy was non-existent, it still demonstrates the dearth of options available. Fushimi is currently the sole submarket with any vacancy, albeit at 0.4%.

All-grade vacancy fell to 2.2% following a 0.7ppts YoY decline. Most of this change was attributed to declines in Meieki and Fushimi. The former narrowed by 1.1ppts and the latter by 0.6ppts. Vacancy in Marunouchi, having fallen below the 3.0% level in the previous report, has seen rates reverse in September. Following steady increases since the start of the year, the vacancy rate of this submarket now sits at 3.4% - the highest of all submarkets.

Rent

Rents for high-grade offices have demonstrated sound growth yet again, with the same submarkets leading the way, namely Fushimi and Marunouchi. These two submarkets grew 17.0% and 11.3% YoY, respectively, as the former experienced a third consecutive period of double-digit YoY growth, while the latter saw a second consecutive period of such growth. Average rents grew 7.8% YoY – a slight slowdown from the previous period.

Solid growth was also seen in the all-grade market, albeit not as impressive. Rents grew 4.0% YoY – the quickest pace in recent history – coming in at JPY11,516 per tsubo per month. Average all-grade rents have now surpassed the previous peak, set in early 2009. Unlike the high-grade market,

TABLE 4: Aichi Prefecture Key Macro Indicators*

	JAPAN	TOKYO	AICHI
Real GDP (JPY trillion)	534.3	103.6	37.4
Real GDP (YoY%)	1.3	1.8	0.7
% of Japan (2015)	100%	20%	7%
Population (million)	126.2	13.9	7.6
Job to applicant ratio	1.6	2.1	1.9

Source Cabinet Office, Aichi Prefectural Government, Savills Research & Consultancy
* Real GDP for Japan is as of Q2/2019, for Tokyo, Aichi and % of Japan, 2015.

TABLE 5: Nagoya High-grade Office

	2H/2019	HOH	YOY
Rent	20,100	2.5%	7.8%
Vacancy	0.1%	0.1ppts	-0.1ppts
Top Rent	36,000+	0	+1,000

Source Savills Research & Consultancy

however, the pace of growth has quickened since the start of the year, most likely driven by those squeezed out of the prime locations. Meieki once again leads the way with rental growth of 6.5% YoY to JPY14,083 per tsubo per month.

Meieki

The range of rents for towers in proximity to the station has held steady, lying between JPY34,000 and JPY36,000. Although supply is scarce, rents are unlikely to exceed the upper bound anytime soon as it appears to be around the limit of what tenants can afford. Average rents in the high-grade Meieki submarket are substantially higher than the other submarkets, having hit a recent high of JPY28,308 per tsubo per month following growth of 5.7% YoY. The range of rents for large-scale offices is also unchanged, remaining between JPY20,000 and JPY30,000.

Fushimi and Marunouchi

Average high-grade rents in these submarkets experienced double-digit YoY growth, with Fushimi leading the way. Despite the solid growth, the range of rents was unmoved, lying between JPY15,000 and JPY24,000 per tsubo per month. The all-grade vacancy rate in Fushimi temporarily loosened following some relocations.

Outlook

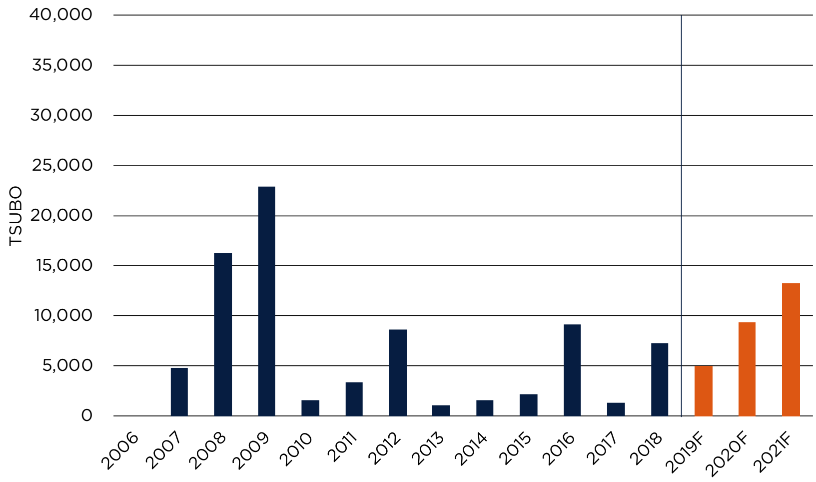
Having experienced exuberant growth during 2018, high-grade office rental growth in Meieki has started to slow in 2H/2019. With rent at a record high, tenants' financial capacities are now being tested and this in turn has been beneficial for the other submarkets.

Lofty rents in the high-grade office market have also been a tailwind for the all-grade market, as prospective tenants continue to be squeezed out of premium locations. As a result, all submarkets in this market segment have experienced an increased rate of growth since the last report, and this is expected to continue.

Rents in Nagoya have been growing at a rapid pace recently, which is no surprise considering the current supply conditions. Though this is set to ease somewhat going forward, the added supply is unlikely to significantly unbalance market forces, allowing rents to continue their upward trajectory. However, we may be witnessing the emergence of a peak, especially in the high-grade office market.

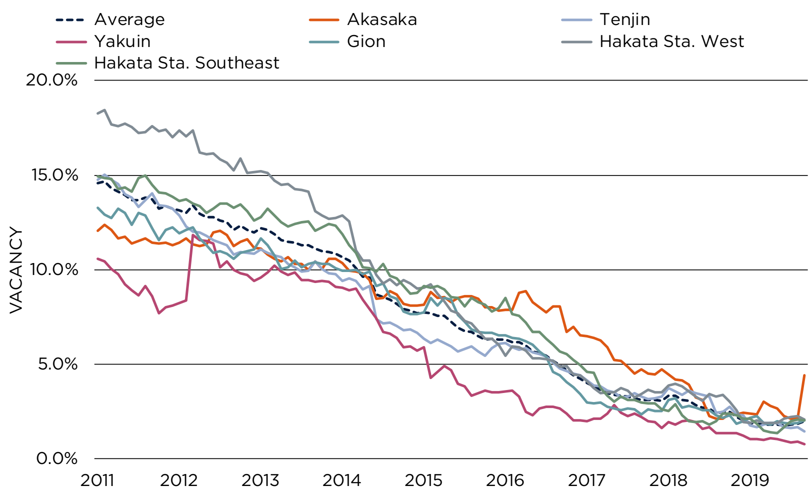
For Nagoya, a risk worth considering is the ongoing US-China trade war. As a manufacturing hub for auto and aerospace products, to name a few, the local economy is at the most risk of being disrupted. Any negative impact should, however, be largely contained to firms directly operating in these sectors.

GRAPH 16: New NRA Office Supply In Fukuoka City, 2006 to 2021F



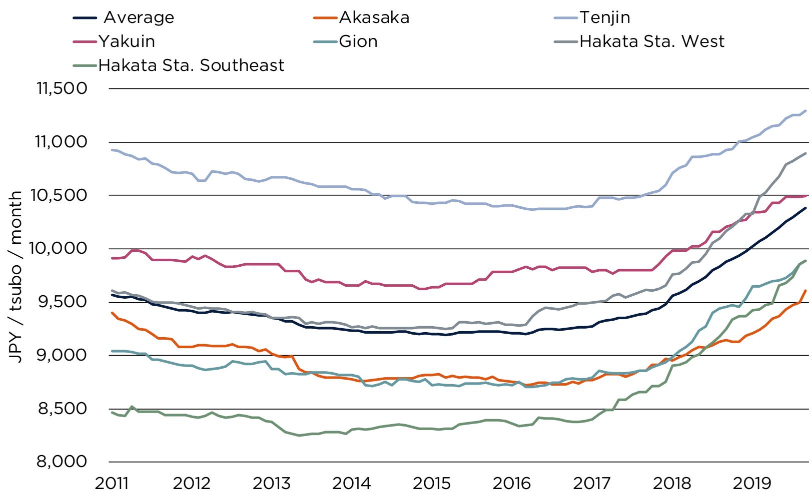
Source Sanko Estate, Savills Research & Consultancy

GRAPH 17: Vacancy Rate In Fukuoka City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

GRAPH 18: Average Rent In Fukuoka City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

FUKUOKA CITY

NRA

Unlike the other regional markets, Fukuoka has seen its fair share of developments this year. However, each project has been small in scale, adding less than 8,000 tsubo of GFA overall, and subsequently, NRA has remained fairly flat around the 700,000 tsubo mark.

Market conditions are expected to change over the next five years thanks to the relaxation of both floor area ratios and building height restrictions. An outcome of these changes is the Tenjin Big Bang development, which commenced in 2015. A key tenet of the project is the redevelopment of, a very ambitious, 30 towers by 2024 which is anticipated to add 95,000 tsubo of GFA, if it should be fully executed. The first project to be completed is the tentatively named Tenjin Business Centre, which will add close to 18,500 tsubo of GFA in 2021. The Hakata Connected Project, announced in May this year, is also set to contribute to supply growth through the development of the areas surrounding Hakata Station. The ambitious aim here is to redevelop 20 buildings within the next 10 years, expanding the supply by up to 48,000 tsubo of GFA.

Despite the above, given relocation constraints, it is more realistic to assume that supply for the next few years will not significantly exceed 10,000 tsubo of NRA per year.

Vacancy

Despite high-grade vacancy holding steady around 0.1% in 2H/2019, over the year, rates tightened by 0.2ppts. Vacancy in the Tenjin submarket experienced the greatest change, falling 0.6ppts to 0.2%. Hakata, having experienced temporary vacancy a year prior, is back to nil.

As of September, all-grade vacancy rates sit at 2.0%, having fallen 0.5ppts YoY. At the submarket level, vacancy rates have recently diverged. The Akasaka submarket has a vacancy rate of 4.4%, a 2.3ppts YoY increase, while the tightest submarket, Yakuin, has a vacancy rate of 0.8% following a 0.6ppts YoY decline. The former's sudden spike in vacancy can be attributed to the completion of the Akasaka-mon Shijyou Building in September, which added over 1,300 tsubo of GFA.

Rent

The positive momentum observed in the previous period has continued, as average high-grade office rents in Fukuoka grew to JPY18,087 per tsubo per month – a 4.5% YoY growth. Despite vacancy rates being similar

TABLE 6: Fukuoka Prefecture Key Macro Indicators*

	JAPAN	TOKYO	FUKUOKA
Real GDP (JPY trillion)	534.3	103.6	18.2
Real GDP (YoY%)	1.3	1.8	2.1
% of Japan (2015)	100%	20%	4%
Population (million)	126.2	13.9	5.1
Job to applicant ratio	1.6	2.1	1.6

Source Cabinet Office, Fukuoka Prefectural Government, Savills Research & Consultancy
* Real GDP for Japan is as of Q2/2019, for Tokyo, Fukuoka and % of Japan, 2015.

TABLE 7: Fukuoka High-grade Office

	2H/2019	HOH	YOY
Rent	18,100	3.0%	4.5%
Vacancy	0.1%	0.0ppts	-0.2ppts
Top Rent	25,000+	0	+2,000

Source Savills Research & Consultancy

to Osaka and Nagoya, rent growth was unable to follow suit, yet again lagging its rivals by as much as 5%.

All-grade rents continue to exceed 2008 peaks and are now at levels not seen since 2002. Rents stand at JPY10,386 after growth of 5.2% YoY – the most out of the other regions. The gap between the submarket with the highest and lowest rate of growth appears to be widening, however. The submarkets adjacent to the station both posted gains of around 7% YoY, while Yakuin, the laggard, grew 2.9% YoY.

Station Front

The range of high-grade rents in proximity to Hakata Station has held firm this period. The average rent, however, has made some gains, rising 6.3% YoY to JPY19,846 per tsubo per month. Having up to now noticeably lagged Tenjin, rents are within touching distance.

Tenjin

Top high-grade rents in the Tenjin area have increased by JPY1,000 to range between JPY14,000 and JPY25,000 per tsubo per month. Pre-leasing for the Tenjin Business Centre appears strong, with rents as high as JPY30,000 rumoured. The Fukuoka Building, also part of the Tenjin Big Bang development, slated for 2024, is anticipated to fetch monthly rents of up to JPY35,000.

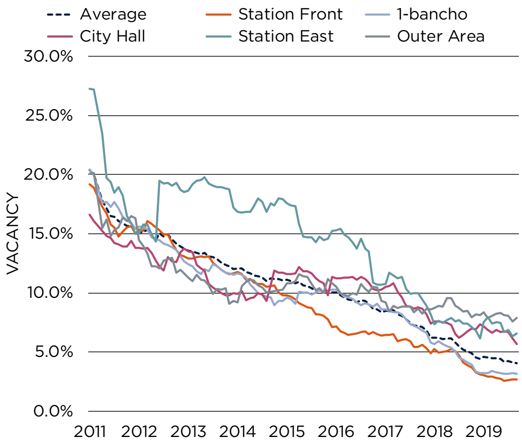
Outlook

The Fukuoka submarket has recently experienced steady rental growth, with the all-grade sector consistently outpacing its regional peers. Leasing transactions are currently taking more time, however, as the previously frantic pace cools, allowing the market to calm.

Fukuoka is the only region in this report predicted to experience strong population growth over the long term. In fact, given the city's attraction for start-ups, much of this positive net migration will be made up of the younger demographic. Furthermore, against a backdrop of supply tightness, Fukuoka is undergoing major structural change. As a result, the two development projects are expected to add a significant number of jobs, greatly benefitting the local economy.

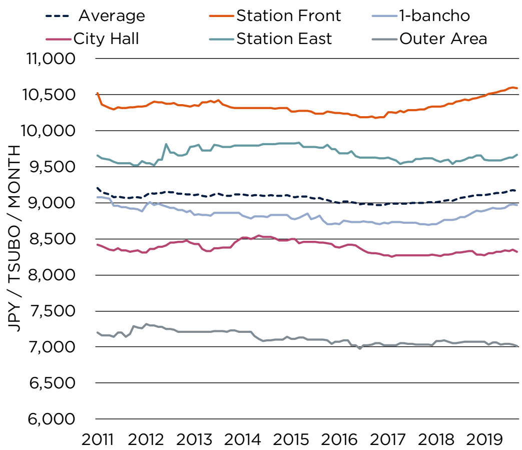
However, risks abound. Despite the expected boost to the local economy, the large supply of office space from these projects combined could destabilise market forces if their ambitions are achieved, subsequently pulling rents down. Furthermore, the Japan-Korea dispute may pose a risk given that Fukuoka attracts a large share of Korean tourists, though the impact on the office market specifically should be limited. Over the shorter term, therefore, rents should be moderately increasing, whilst longer term prospects are more uncertain, given the relatively large development pipeline.

GRAPH 19: Vacancy Rate In Sendai City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

GRAPH 20: Average Rent In Sendai City, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

SENDAI CITY

Supply and Demand

The Sendai office market has stabilised around 0.5 million tsubo of NRA due to a lack of large-scale developments since 2013. However, change is looming. There are plans for two developments in 2020, with another to follow the year after. The result should be up to 13,000 tsubo of GFA coming online, with the largest of these projects being the development on the east side of Sendai Station –expected to add around 8,000 tsubo of GFA in 2021.

Since 2014, Sendai has been working to rebrand itself as an attractive option for start-ups by offering incentives, such as subsidies, and it appears that these initiatives have been bearing fruit. For instance, according to the NLI Research Institute, between 2014 and 2016, Sendai ranked second, after Fukuoka, for the proportion of start-ups created locally. On the back of this success, the local government has announced a new initiative to support entrepreneurs to further grow the local economy by 2023. The steady inflow of start-ups in Sendai should, therefore, help to underpin the sustainability of office demand growth going forward.

Vacancy

As of September, the average all-grade vacancy rate in Sendai fell by 1.0ppts YoY to 4.1% – the lowest level since 1992. The most convenient locations, namely the Station Front and 1-bancho submarkets, as expected, have the tightest vacancies, coming in at 2.7% and 3.2%, respectively. However, the pace of change has started to wane across most submarkets compared to a year ago. The Outer Area is the sole detractor following a 0.6ppts compression of vacancy rates to 7.9%, compared to a 0.2ppts decline in September 2018.

Since the start of the year, leasing volumes have been low, with most deals, if any, being small or medium in scale. Accordingly, the vacancy rate has hovered close to the 4.3% mark.

Rent

Despite rents growing for seven consecutive months between January and August, average all-grade rents in Sendai remain below 2008 peaks. Compared to the previous month, rents in September fell to JPY9,169 per tsubo per month due to a slight downward revision in demanded rents. Over the year, however, rents rose 0.9%.

Rent growth amongst the submarkets was, however, mixed. The Station Front and 1-bancho submarkets continue to prop up average growth, with increases of 1.7% and 1.6% YoY, respectively. The Outer area, despite vacancy rates tightening as discussed above, saw rents decline 0.8% YoY to JPY7,017 per tsubo per month – the lowest since mid-2016.

Outlook

Vacancy continues to tighten in Sendai, and the pace of this change has recently outstripped its regional rivals. Despite this, rents have been slow to react and still sit below 2008 peaks. Given the absence of new developments planned for the rest of 2019, vacancy rates should continue their downward trend for the time being, though this is anticipated to change slightly as supply is relaxed through large-scale developments in the near future.

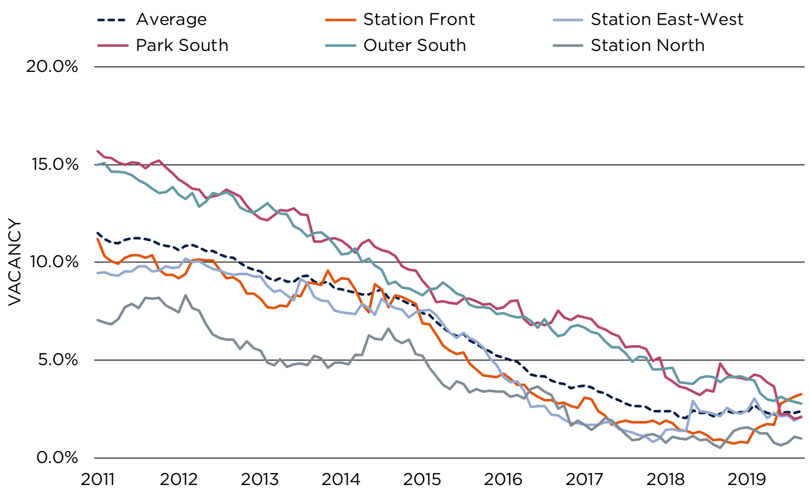
In the presence of this relatively limited supply, we should see some rent growth over the shorter term with demand perhaps being driven by the entrepreneurial community.

TABLE 8: Miyagi Prefecture Key Macro Indicators*

	JAPAN	TOKYO	MIYAGI
Real GDP (JPY trillion)	534.3	103.6	9.3
Real GDP (YoY%)	1.3	1.8	1.8
% of Japan (2015)	100%	20%	2%
Population (million)	126.2	13.9	2.3
Job to applicant ratio	1.6	2.1	1.6

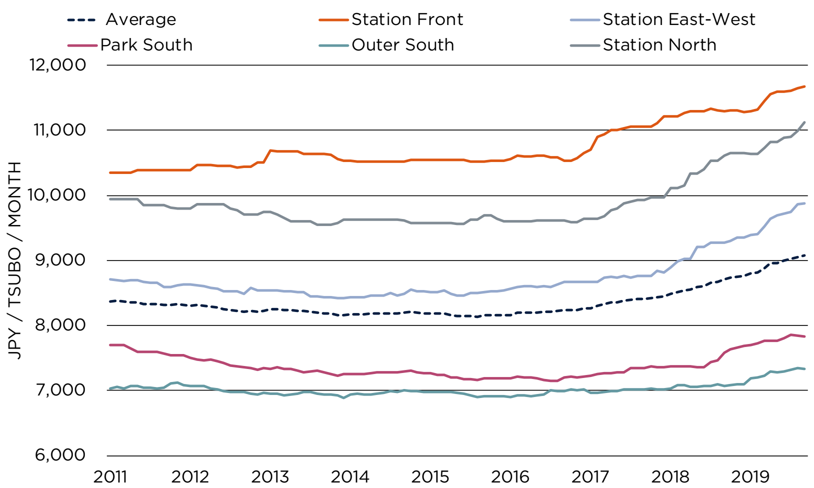
Source Cabinet Office, Miyagi Prefectural Government, Savills Research & Consultancy
* Real GDP for Japan is as of Q2/2019, for Tokyo, Miyagi and % of Japan, 2015.

GRAPH 21: Vacancy Rate In Sapporo City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

GRAPH 22: Average Rent In Sapporo City By Area, 2011 to 2019



Source Miki Shoji, Savills Research & Consultancy

SAPPORO CITY

Supply and Demand

Sapporo has added supply to the market every year since 2010, and this year has been no exception. The completion of the Sousei East Building and the Minami Odori Building Ichijo in 1H/2019 has added around 3,900 tsubo of GFA combined. Yet, total office NRA remains unchanged at around the 0.51 million tsubo mark following some demolitions. Going forward, however, office supply growth should be achieved by the completion of the tentatively named Shin-oroshi Centre Building later this year – adding around 6,300 tsubo of GFA. In addition, over 8,000 tsubo of GFA is due in 2020, most of which is attributed to the Daido Seimei Building, slated for completion in Q1.

Incentives provided by the local government continue to support office demand, and firms in the call centre industry, especially, have benefitted greatly. Incentives, such as JPY500,000 for each job created, have led to Sapporo becoming the number one destination for call centres in Japan, with around 81 facilities in total, according to a study undertaken by Call Centre Japan Magazine in July 2018.

Vacancy

The average all-grade vacancy rate for Sapporo has seesawed between 2.0% and 3.0% since June 2017. As of September 2019, after a slight increase of 0.1ppts YoY, vacancy sits at 2.4%. Station North retook the status of tightest submarket despite a 0.5ppts YoY loosening of vacancy rates to 1.0%. This was helped by the significant increase in vacancy of 2.3ppts YoY in the Station Front submarket – a seventh consecutive month of loosening – following multiple cases of large-scale cancellations.

TABLE 9: Hokkaido Prefecture Key Macro Indicators*

	JAPAN	TOKYO	HOKKAIDO
Real GDP (JPY trillion)	534.3	103.6	18.3
Real GDP (YoY%)	1.3	1.8	1.1
% of Japan (2015)	100%	20%	4%
Population (million)	126.2	13.9	5.3
Job to applicant ratio	1.6	2.1	1.2

Source Cabinet Office, Hokkaido Prefectural Government, Savills Research & Consultancy
* Real GDP for Japan is as of Q2/2019, for Tokyo, Hokkaido and % of Japan, 2015.

Rent

All-grade rental growth has exceeded 4% YoY for the first time since the data was first collected, and as a result, 2008 peaks have been surpassed. Average rents now stand at JPY9,072 tsubo per month following a rise of 4.2% YoY. The three most expensive submarkets have also followed suit, namely Station Front, Station East-West and Station North. As the most expensive submarket, Station Front commands rents of JPY11,667 per tsubo per month. With demand outstripping supply in these convenient locations, the Station East-West submarket, for example, experienced a solid 6.5% YoY growth. Park South, which had demonstrated annual growth exceeding 5% for most of the year, has seen a decline, however, slowing to a gain of 3.3% YoY.

Outlook

The office market in Sapporo has hitherto been supported by tight supply and sound demand. Following rental increases in the most convenient submarkets, average rents now exceed 2008 peaks.

A major source of this demand has come from call centres, and to some extent, IT firms, which have made use of the subsidies provided by the local government. However, change is on the horizon. Cost pressures arising from wage increases, as a result of demographic headwinds, combined with rising rents, are squeezing profits for these businesses. Furthermore, business continuity plan considerations and a shift in focus towards technologies that can reduce costs, as well as the need for office space, may start to impact Sapporo's appeal, and thus office demand.

Given the level of rents at present, it is not surprising to see some rationality return to the market. This normalisation of market forces, therefore, may result in rents remaining flattish for the time being.

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