Japan - July 2022

SPOTLIGHT
Savills Research

Regional Japanese Office Markets

savills

Recovery underway with challenges ahead

Summary

- With the exception of Fukuoka, investment-grade offices in all regions have seen mild corrections. All markets have seen vacancy increments, with Nagoya seeing the largest increase.
- All-grade office rents have seen divergence between markets, with some experiencing growth and others observing mild corrections.
- Cap rates for Grade A offices have tightened across markets again, demonstrating some bullish sentiment in the sector.
- Investment volumes in 2021 were almost the same as those in 2020 and 2019.
- Many regional cities are expecting notable supply in the coming years, which could be a challenge for some, but well received in others.
- Recovery will likely be dependent on specific properties, rather than performance at the submarket level.

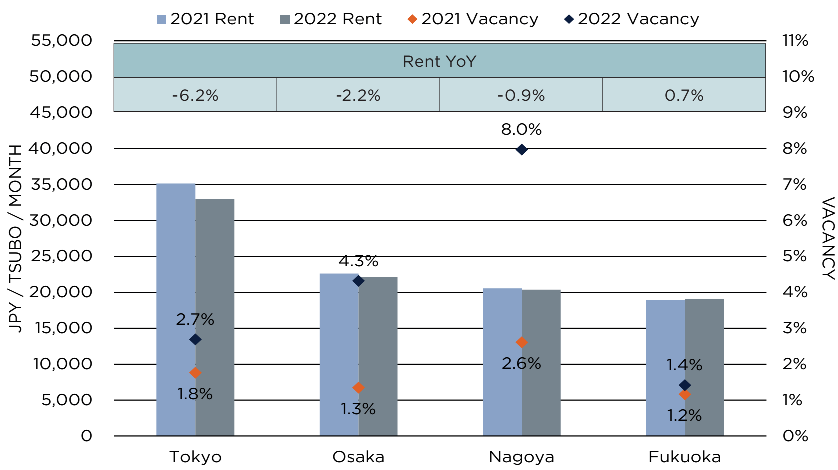
OVERVIEW

The pandemic has steadily shifted to an endemic state, and many restrictions have been lifted. Office attendance also appears to have been steady - according to Google Mobility reports, workplace mobility in Japan has remained at around 90% for over the past half-year compared to pre-pandemic levels, showing that people have been commuting to the office unperturbed by the pandemic, a trend prevalent especially outside of Tokyo.

For investment-grade offices, rents have declined slightly in all markets over the past half-year, with the exception of Fukuoka where rents stayed flat.

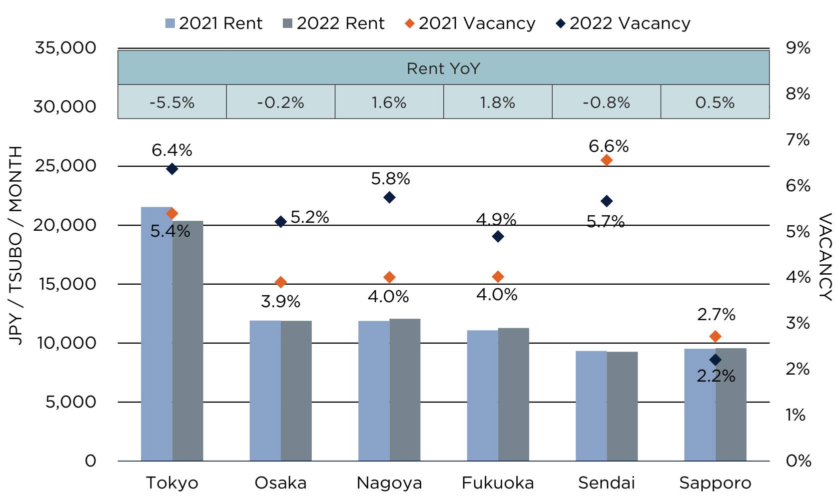
All-grade regional offices have seen some diverging trends. Osaka and Sendai saw mild corrections in rents while Nagoya, Fukuoka, and Sapporo saw marginal increments over the past year. In contrast, Tokyo saw a 5.5% decline YoY in all-grade rents, suggesting that regional markets have overall been performing better in comparison. Meanwhile, vacancy in Osaka, Nagoya, and Fukuoka has loosened modestly to an extent similar to that of Tokyo, with Nagoya observing the most

GRAPH 1: Investment-grade Office Performance, 1H/2022



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

GRAPH 2: All-grade Office Performance, 1H/2022*



Source Miki Shoji, Savills Research & Consultancy
*Market data as of Mar 2021 and Mar 2022

notable increment of 1.8 percentage points (ppts) YoY.

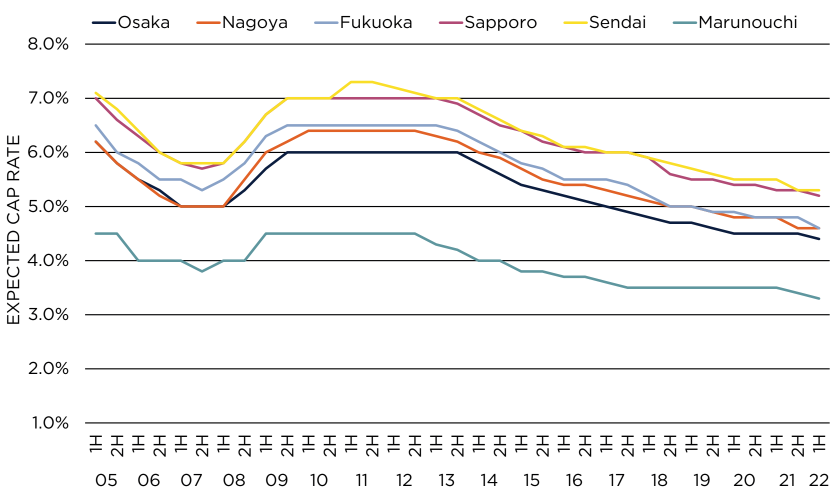
REGIONAL INVESTMENT

According to the bi-annual investor survey conducted by the Japan Real Estate Institute (JREI) in April 2022, expected cap rates in Fukuoka have tightened 20 basis points (bps), and those in Osaka have decreased 10bps from the previous half year. Many submarkets in Tokyo have also seen cap rates tighten 10bps over the same period. Indeed, cap rates have been compressing over the past two years despite the pandemic, signalling that there is a growing amount of investor interest in the office sector.

Despite the pandemic, transaction volumes in 2021 and 2020 were nearly the same as those of 2019. Specifically,

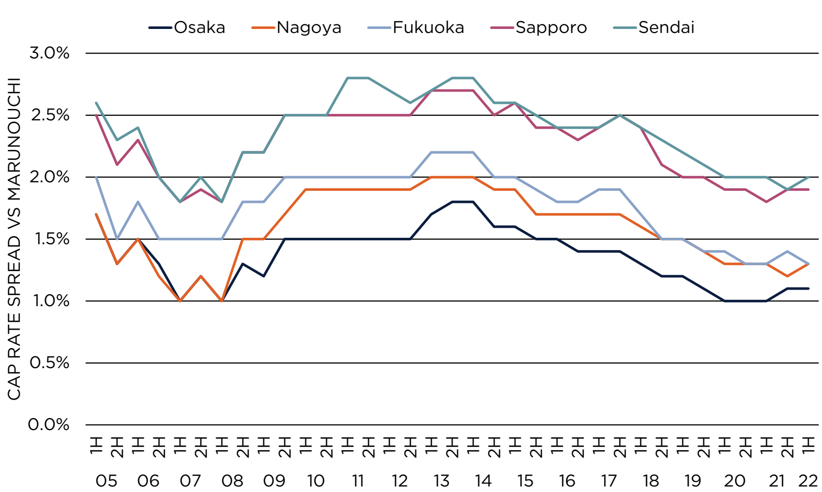
The pandemic has transitioned into an endemic state, which has created a more optimistic environment for office recovery. At the same time, there are challenges ahead including the large supply of new offices in the pipeline. While a majority of offices appear to be doing well, a handful with bullish rents have high levels of vacancy. As such, recovery will need to be analysed at the property level, and not the submarket level.

GRAPH 3: Expected Cap Rates for Grade A Offices, 2005 to 1H/2022



Source Japan Real Estate Institute, Savills Research & Consultancy

GRAPH 4: Expected Cap Rate Spreads (vs Marunouchi), 2005 to 1H/2022



Source Japan Real Estate Institute, Savills Research & Consultancy

investment volumes in 2021 were only around 7% lower than those in 2020. Meanwhile, the office sector saw a 5% increase over the same period. While 2022 has had a relatively slow start in its first quarter, it should be noted that figures for 2022 are preliminary, and expected to increase as more transactions are confirmed.

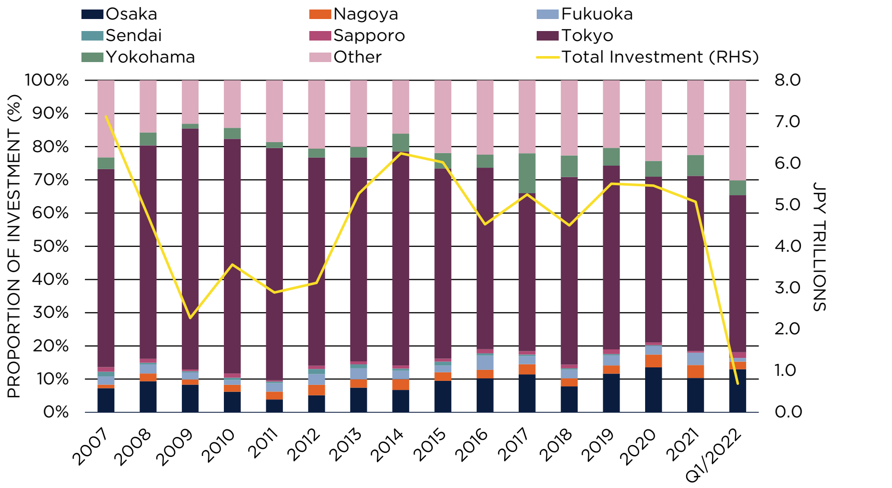
Looking closely at different cities, investment volumes in Fukuoka have been on the rise, with 2021 marking the largest investment volumes seen in the city since 2016. A number of mid-sized office transactions by Samty, and a few large hotel transactions involving Hoshino Resorts contributed to these sizable volumes.

There were some notable big-ticket transactions that transpired over the past half-year by both international and domestic investors. For instance, Morgan Stanley acquired the remaining 50% ownership in the Yokohama Nomura Building after acquiring the previous 50% for JPY33 billion, and now fully owns the building. Elsewhere, Nippon Building Fund acquired the Nakanoshima Mitsui Building in Osaka from its sponsor Mitsui Fudosan for JPY44 billion. More large transactions are expected during the remainder of the year as more capital looks for opportunities beyond Tokyo.

OUTLOOK

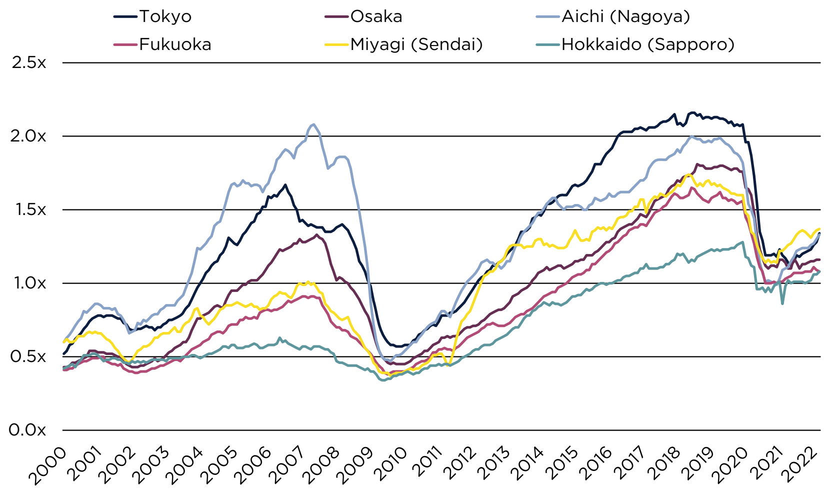
Overall, the regional office markets have seen modest recoveries in rents amidst slight loosening in vacancy over the past half-year, and have outperformed Tokyo. Indeed, regional markets had lower implementation rates of remote work, and have overall been

GRAPH 5: Investment Volumes by Area for All Asset Types, 2007 to Q1/2022



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

GRAPH 6: Job-to-applicant Ratios, Selected Prefectures, 2000 to March 2022



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

less impacted by the pandemic. In fact, office utilisation in Japan has not changed significantly over the past six months, remaining at around 90% of pre-pandemic levels.

The Japanese economy as a whole appears to have mostly shifted to an endemic state. Despite some slowdown in the global economy because of the situation in Ukraine and high energy prices, economic recovery is expected to gain momentum in the transition out of the pandemic, which should help to bolster the office market.

However, the regional markets will face potential challenges, including the large supply of offices. Vacancy loosening caused by large supply could be a potential concern for some markets.

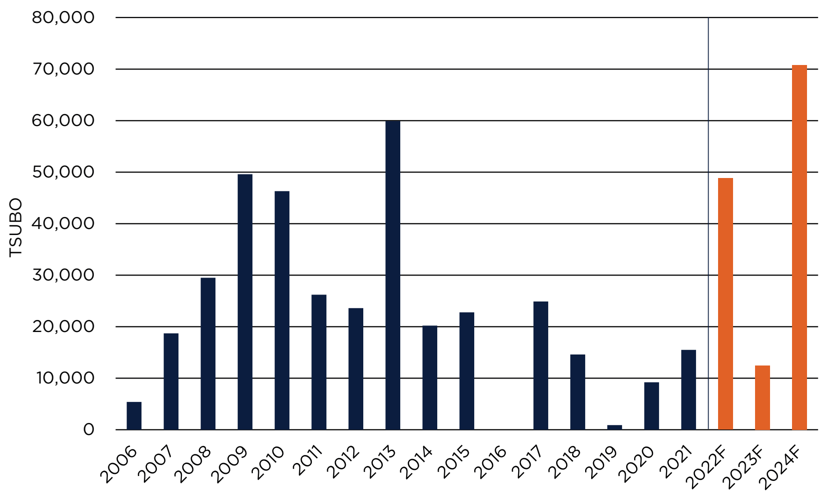
Nonetheless, rents have generally remained flattish, partially thanks to newly introduced offices with above-average rents, and vacancy looks to be stabilising, which are positive signs for the market. Additionally, the lacklustre metrics of overall markets seem to be attributed to certain buildings that are struggling to acquire tenants. Indeed, newer ones that appear overpriced and without defining selling points in particular are having difficulties. Recovery is therefore likely to be highly dependent on the future performances of specific properties, rather than on the submarket as a whole.

TABLE 1: BOJ Regional Economic Assessment, April 2022

REGION	TREND	CHANGE VS JANUARY 2022
Hokkaido (Sapporo)	"The economy has seen a pause in signs of a pick-up as downward pressure has been strong due to the impact of COVID-19."	
Tohoku (Sendai)	"The economy has seen a pause in signs of a pick-up."	
Kanto-Koshinetsu (Tokyo)	"The economy has picked up as a trend, although it has been weak, mainly due to the impact of COVID-19."	
Tokai (Nagoya)	"The economy has seen a pause in signs of a pick-up."	
Kinki (Osaka)	"The economy has generally been on a pick-up trend, although the impact of COVID-19 on consumption has been observed."	
Kyushu (Fukuoka)	"The economy has seen a slowdown in the pace of its pick-up."	

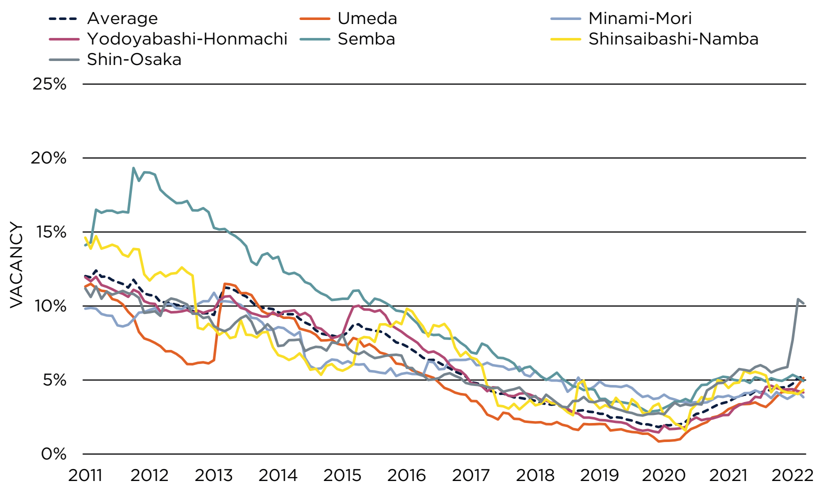
Source Bank of Japan, Savills Research & Consultancy

GRAPH 7: New NRA Office Supply in Osaka City, 2006 to 2024F



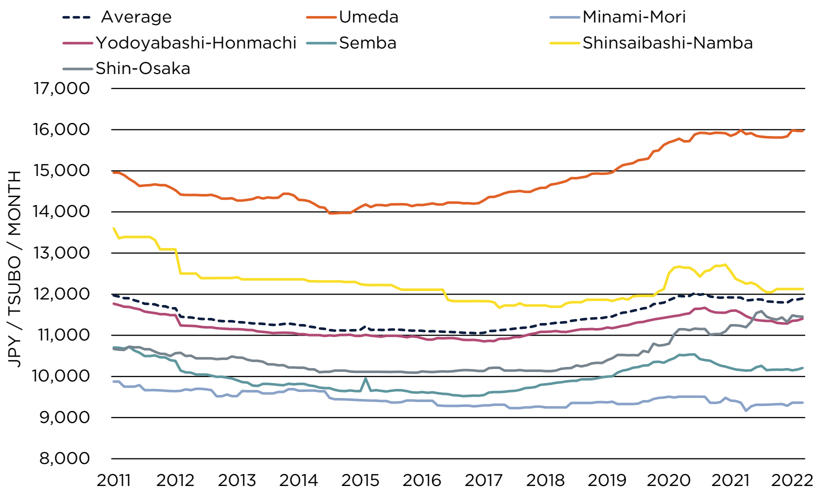
Source Sanko Estate, Building Group, Savills Research & Consultancy

GRAPH 8: Vacancy Rate in Osaka City by Area, 2011 to Q1/2022



Source Miki Shoji, Savills Research & Consultancy

GRAPH 9: Average Rent in Osaka City by Area, 2011 to Q1/2022



Source Miki Shoji, Savills Research & Consultancy

OSAKA CITY

Net Rentable Area (NRA)

2022 looks to add more supply to the market than the total amount seen between 2018 and 2021. The largest addition, Osaka Umeda Twin Towers South, has opened about 85% occupied despite its high rents of JPY38,000 per tsubo. Meanwhile, the Nippon Life Yodoyabashi Building, which will come to the market in the second half of 2022, is largely pre-leased.

The relatively low supply in 2023 should also give the market some breathing room. However, 2024 is forecast to add about 70,000 tsubo of NRA to the market, of which a significant portion will be concentrated around the Umeda area. Furthermore, much of this new supply is expected to have high asking rents. For instance, the Umeda 3rd Project, which will come to the market in that year, has already seen some pre-leasing activity, and looks to have rents of JPY38,000 per tsubo, aiming to achieve current top rents in the Osaka station area. While there is concern over the large number of high-quality buildings to be added within a short period of time, the economy still has two years to recover and grow. Indeed, given the strong office demand by the station front area, it is possible that the supply will be absorbed uneventfully, similar to the situation in Nagoya in 2015 and contrary to expectations at the time.

Vacancy

Investment-grade vacancy rates have increased 1.5ppts HoH to 4.3%. Many new buildings that opened in Shin-Osaka are the root cause of this increment, whereas other submarkets are performing soundly.

All-grade vacancy rates have climbed higher by 0.9ppts HoH to 5.2%. Vacancy rates in new buildings remain notably higher than the average rate, resulting in vacancy increments in Shin-Osaka and Umeda.

Rent

Rents in investment-grade offices have decreased 1.4% HoH to JPY22,100 per tsubo. However, most of this decline was the result of new offices of below-average rent being added to the market. Most existing buildings have either seen flattish rents or very mild corrections, if any.

All-grade rents have inched up 0.6% HoH to around JPY11,900 per tsubo. All submarkets saw mild increments over the past half-year. Umeda observed the largest gain of 1.0% HoH to JPY16,000 per tsubo, stemming primarily from new buildings that entered the market.

TABLE 2: Osaka Investment-grade Offices

	1H/2022	HOH	YOY
Rent	22,100	-1.4%	-2.2%
Vacancy	4.3%	+1.5ppts	+3.0ppts
Top Rent	38,000	+3,000	+3,000

Source Savills Research & Consultancy

Umeda

Rents for investment-grade offices have increased 1.8% in the Umeda submarket to JPY25,600 per tsubo, primarily due to the addition of the Osaka Umeda Twin Tower South. Vacancy has also loosened slightly to 4.3%, also primarily stemming from this building and some secondary vacancy that arose from it.

The new premium building in Umeda has contracted tenants at JPY38,000 per tsubo, and looks to maintain these bullish rents. This new building has increased the top rent in Osaka by JPY3,000 per tsubo. Similar buildings in the future are likely to attempt to follow in step.

Yodoyabashi-Honmachi

Investment-grade office rents in the Yodoyabashi-Honmachi submarket have stayed flat over the past half-year at JPY23,000 per tsubo. Vacancy has tightened 4.6ppts HoH to 3.8%, mostly from the improving status of the Honmachi Sankei Building, that has managed to fill a notable amount of space.

The Nippon Life Yodoyabashi Building looks to come to the market in the second half of 2022 mostly leased with rents in the higher JPY20,000 per tsubo range. Honmachi Garden City Terrace, developed by Sekisui House and coming to the market in early 2023, is expected to have asking rents of JPY30,000 per tsubo, setting a new high for the submarket. However, there are no rumours of tenants other than WeWork.

Shin-Osaka

Shin-Osaka's investment-grade rents fell 5.0% HoH to JPY19,400 per tsubo, purported by corrections seen across many buildings. Indeed, many offices still appear to be suffering and have rapidly adjusted rents in order to secure tenants.

The situation in Shin-Osaka appears grim as many newly released offices have stark levels of vacancy. Indeed, the Shin-Osaka Dai 3 NK Building came to the market mostly vacant, and will likely continue contributing to the submarket's high average vacancy.

Aside from its close proximity to the Shinkansen, Shin-Osaka is located awkwardly further away from other central offices, and has poorer access. In addition, many new offices in the area are far from Shin-Osaka station, which makes it even more difficult to attract new tenants that are conscious about convenient access.

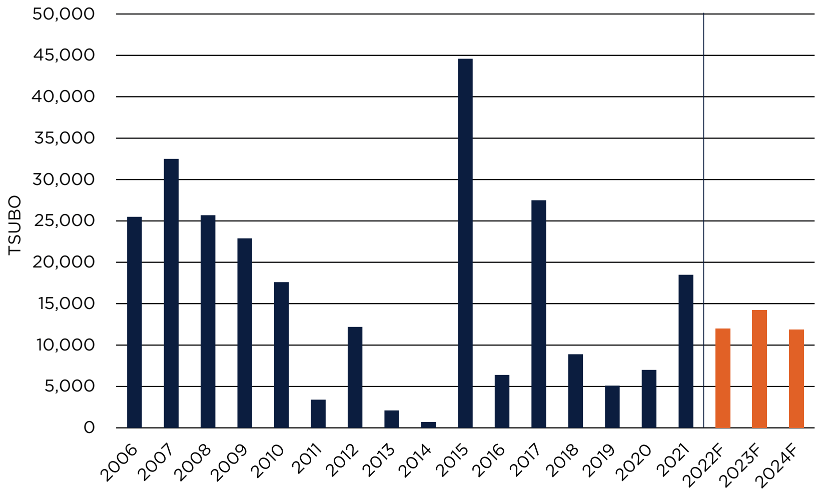
Outlook

Overall, demand in the Osaka office market looks to have plateaued, with contracted rents remaining flattish or weakening slightly. That said, the new Umeda Twin Towers South has set a new high for rents in Osaka, demonstrating the presence of some demand for premium buildings. More buildings will follow in 2024 and transform the landscape of Umeda.

At the same time, Shin-Osaka looks to be in a precarious situation. Indeed, many of its new buildings remain mostly vacant, and other buildings in the submarket have also seen corrections. This situation may persist until an equilibrium price point has been attained. As such, the submarket will likely take slightly longer to recover.

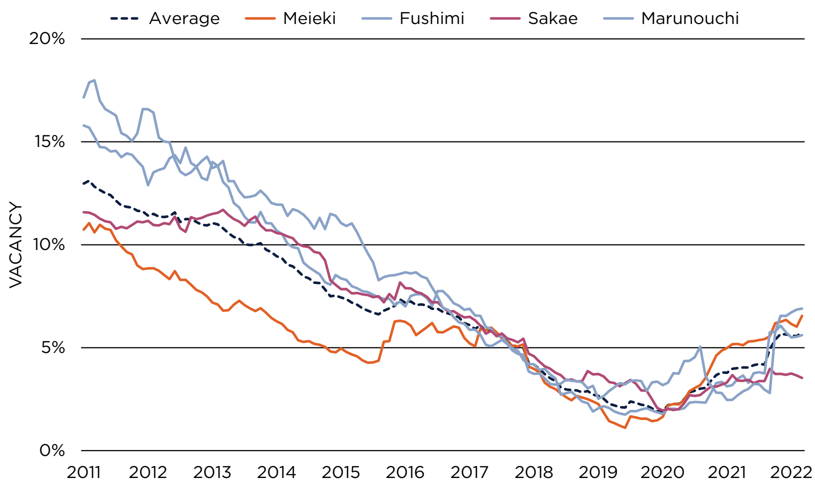
Looking ahead, a large amount of supply is forecast for 2024 with a heavy focus in Umeda that is expected to transform the region. While the new supply is expected to increase average rents, the vacancy arising from it may be a problem. Nonetheless, the ongoing developments in Osaka such as Expo 2025 and the anticipated integrated resorts in 2029 could catalyse greater economic development and spur demand for more office space in the coming years, providing some hope for the market.

GRAPH 10: New NRA Office Supply in Nagoya City, 2006 to 2024F



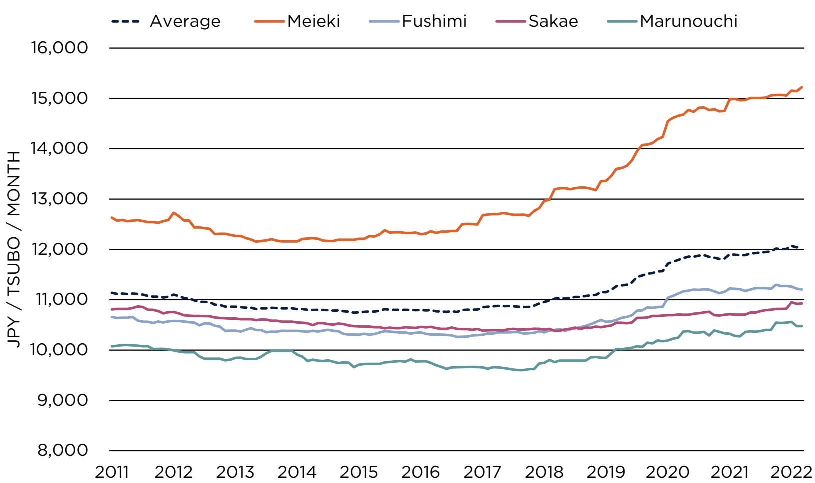
Source Sanko Estate, Savills Research & Consultancy

GRAPH 11: Vacancy Rate in Nagoya City by Area, 2011 to Q1/2022



Source Miki Shoji, Savills Research & Consultancy

GRAPH 12: Average Rent in Nagoya City by Area, 2011 to Q1/2022



Source Miki Shoji, Savills Research & Consultancy

NAGOYA CITY

NRA

Some of the new supply in 2022 appears to have been well received so far. For instance, the Urbannet Nagoya Nexta Building with about 5,000 tsubo of NRA opened in early 2022 is almost at full capacity after having attracted large tenants including NGK.

At the same time, another new building has come to the market almost completely vacant. This demonstrates the divergence between different pricing strategies. Presently, only buildings at the right price appear able to fill floors in the current market environment.

Looking at the market between 2022 and 2024, a steady level of supply is forecast to be added every year. In 2023, one of the largest projects, the Chunichi Building will add almost 10,000 tsubo of NRA, and is set to become a landmark in the Sakae area. Its location and prominence should allow it to find tenants. In 2024, the Nagoya Marunouchi 1-Chome Project looks to add more than 8,500 tsubo of NRA to the market. While the moderate amount of supply over these years should make it comparatively easier to absorb, new buildings without clear selling points may lose out to other vacant buildings.

Vacancy

Investment-grade office vacancy in Nagoya has seen a significant increase of 4.8ppts HoH to 8.0%. However, the main sources of this increment were a few buildings, mostly new ones, that have a striking amount of vacant space. A vast majority of buildings in the market are actually performing well with only nominal levels of vacancy, if any at all. The market as a whole might see vacancy inch upward going forward, especially if these buildings do not adjust rents in response to the market.

All-grade market vacancy has increased 0.9ppts over the past half-year to 5.8% in 1H/2022. However, there was some divergence between the performances of respective submarkets. For instance, Marunouchi saw a significant increase in vacancy of 2.8ppts HoH to 5.6%. Some vacancy persists in a few buildings, especially Marunouchi One. Meanwhile, vacancy in Sakae has tightened slightly by 0.5ppts to 4.0%.

Rent

In 1H/2022, investment-grade office rents saw a slight uptick of 0.8% HoH to JPY20,400 per tsubo. Most of these gains originated from the addition of

TABLE 3: Nagoya Investment-grade Offices

	1H/2022	HOH	YOY
Rent	20,400	0.8%	-0.9%
Vacancy	8.0%	+4.8ppts	+5.4ppts
Top Rent	35,000+	0+	0+

Source Savills Research & Consultancy

new buildings with above-average rents. Other buildings have seen rents stay mostly flat over the past half-year, and some popular buildings with great accessibility have even seen rents surpass pre-pandemic levels, showing the stability of the market's rents in general.

Meanwhile, all-grade rents inched up 1.0% HoH to JPY12,100 per tsubo. Sakae and Meieki saw rent increments of 1.1% HoH each, boosted by the addition of new buildings. At the same time, Fushimi saw a slight correction in rents of 0.1% HoH.

Meieki

Meieki's investment-grade office rents increased 2.4% HoH to JPY27,700 per tsubo. A majority of buildings in the submarket are performing well, and some have even increased rents. Meanwhile, vacancy has increased 2.1ppts HoH to 5.2%, although this was primarily due to the addition of Nagoya Building Sakura-Kan, which came to the market in 2022 with high vacancy.

Top rents in the submarket have reached JPY35,000+ per tsubo and are somewhat strengthening. The Meieki 4-Chome OT Project, which is slated to come to the market in 2023, is expected to have asking rents at an ambitious JPY30,000.

Fushimi and Marunouchi

Investment-grade office rents in Fushimi and Marunouchi have both seen corrections in 1H/2022. Fushimi's rents decreased 1.5% HoH to JPY18,500 per tsubo, while Marunouchi's rents decreased 2.1% to JPY16,400 per tsubo.

Meanwhile, vacancy in both submarkets saw significant increments. Over the past half-year, vacancy in Fushimi increased 15.5ppts to 16.8%, while Marunouchi increased 10.1ppts to 12.2%. While these sharp jumps in vacancy might appear alarming at first, it should be noted that a majority of buildings in both submarkets performed well. The high vacancy levels were skewed by a few buildings, most of which opened in the past year, which have very high levels of vacancy. Notable corrections in rent or incentives appear necessary in order to attract tenants for these buildings.

In 2024, the Nagoya Marunouchi 1-Chome Project is expected to add about 8,500 tsubo of NRA to the market with rents of JPY21,000+ per tsubo. Pre-leasing activity appears to be going well even though it is still early, showing that there is demand for reasonably priced, quality offices.

Outlook

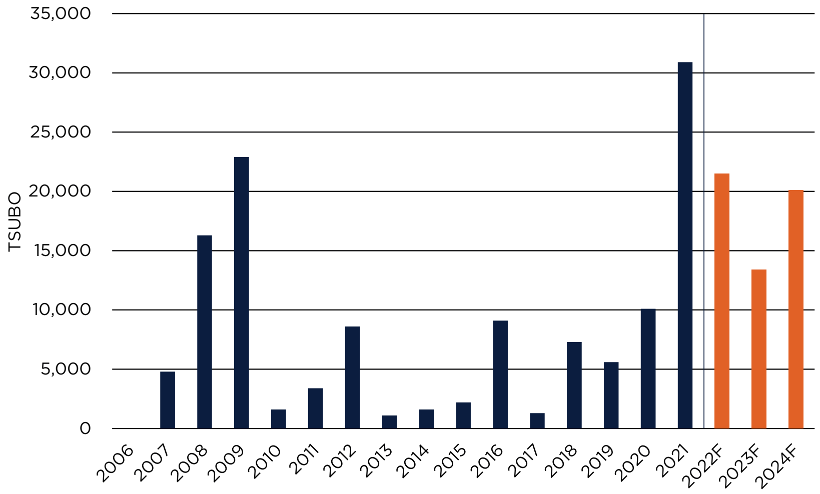
The Nagoya office market has seen a number of mixed signals over the past half-year. On the one hand, some new investment-grade buildings such as the Urbannet Nagoya Nexta Building have been well received and are operating at near full occupancy. At the same time, other new buildings appear to be having a harder time attracting tenants at their current rental levels.

Indeed, it appears that the success of new buildings in the Nagoya market is highly dependent on correct pricing and the building's selling points. Hence, recovery will need to be analysed at the property level, not at the submarket level. Indeed, some buildings in different submarkets have obvious vacancies, providing further evidence for this trend.

Meanwhile, rents should overall stay flattish going forward, as attractive buildings could look to increase rents, while others might need to see corrections to attract tenants. Overall, the market appears sound, with the exception of a few buildings that have upheld bullish rents despite the high vacancies.

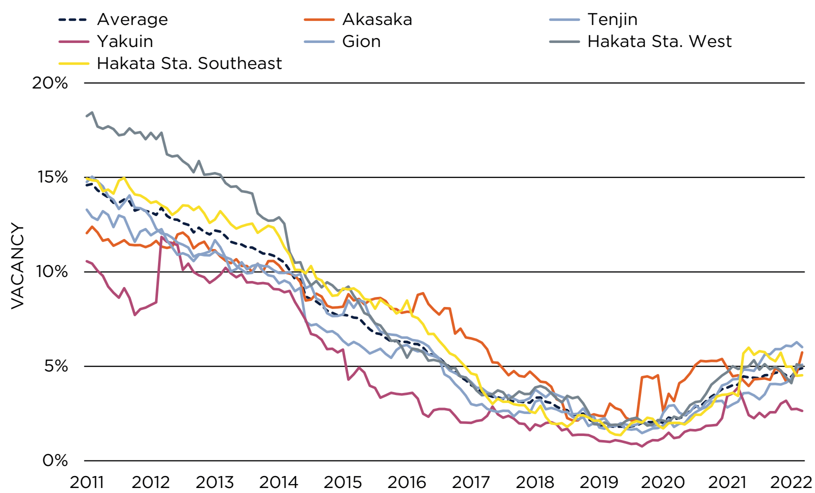
However, there are other challenges on the horizon as Nagoya's primary manufacturing sector may face some hurdles due to increasing energy prices and supply chain disruptions. Nonetheless, the market looks stable in the long-term, especially when considering developments in downtown areas like Sakae that look to improve the city's liveability and attractiveness.

GRAPH 13: New NRA Office Supply in Fukuoka City, 2006 to 2024F



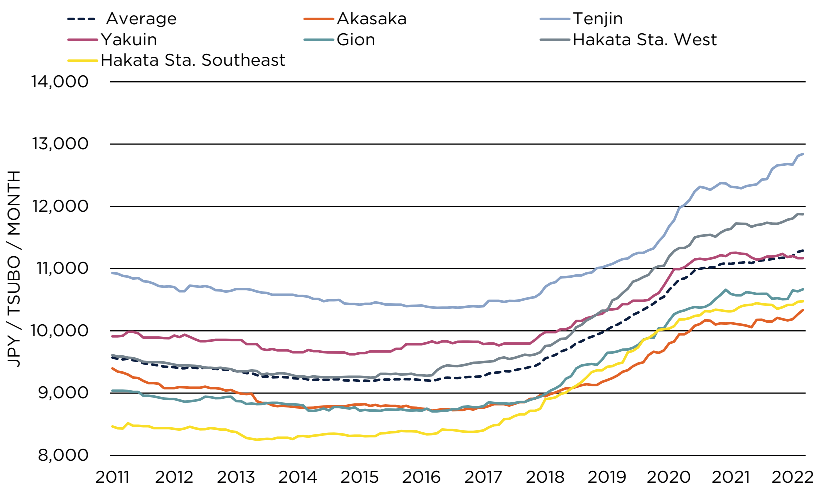
Source Sanko Estate,Savills Research & Consultancy

GRAPH 14: Vacancy Rate in Fukuoka City by Area, 2011 to Q1/2022



Source Miki Shoji, Savills Research & Consultancy

GRAPH 15: Average Rent in Fukuoka City by Area, 2011 to Q1/2022



Source Miki Shoji, Savills Research & Consultancy

FUKUOKA CITY

NRA

In Fukuoka, the market appears to have received the enormous supply in 2021 well. The new supply in 2022 has also been well received so far – Hakata East Terrace and Fukuoka Maizuru Square, which will add a total of around 11,000 tsubo of NRA, are reportedly almost fully occupied or fully pre-leased.

However, the pre-leasing situation for Fukuoka Daimyo Garden City is not as optimistic. This building will add more than 9,000 tsubo of NRA in December 2022, and is rumoured to be around 30% pre-leased, although there is admittedly still time before the building comes to the market. Nevertheless, if the building comes online with a large amount of vacancy, this may destabilise the sound momentum present in the market.

The supply between 2022 and 2024, while not as large as what was seen in 2021, will be significantly greater than the average amount between 2010 and 2020. Presently, some mixed signals have appeared in the market, with some rumours indicating that more than half of the Fukuoka Building coming online in 2024 has been pre-leased at JPY32,000+ per tsubo, setting new top-rents in Fukuoka, but with few positive rumours regarding the 2023 supply. Overall, the performance of the buildings coming online in 2022 is an encouraging indicator for the outlook of the market so far.

Vacancy

Investment-grade vacancy tightened by 0.9ppts HoH to 1.4%. Some vacant space from new supply available at the end of 2021 has been taken up, and the new addition, Maizuru Square, is almost fully occupied. Overall, Fukuoka appears to have been received most of its new supply well.

The all-grade market saw a slight increase in vacancy – 0.3ppts HoH to 4.9%. Here, the Akasaka submarket saw the largest increment in vacancy of 1.5ppts HoH to 5.7%. Meanwhile, vacancy in Hakata Station Southeast has contracted 0.9ppts HoH, showing that the new supply added is gradually being absorbed.

Rent

In 1H/2022, investment-grade rents in Fukuoka stayed flat over the past half-year at JPY19,100 per tsubo. While some buildings saw moderate rental corrections, others have actually increased rents. Meanwhile, the new Fukuoka Maizuru Square has asking rents in line with the market.

All-grade rents in Fukuoka increased 1.2%

TABLE 4: Fukuoka Investment-grade Offices

	1H/2022	HOH	YOY
Rent	19,100	0.0%	0.7%
Vacancy	1.4%	-0.9ppts	+0.2ppts
Top Rent	30,000	0	+5,000

Source Savills Research & Consultancy

HoH to JPY11,300 per tsubo, again attaining new record highs. The main drivers of rental growth this half-year were Tenjin and Akasaka, which grew 1.9% and 1.8% HoH, respectively.

Hakata

Rents of investment-grade buildings in Hakata have stayed flat over the past half-year at JPY20,400 per tsubo, and rents still range between JPY17,000 and JPY25,000+ per tsubo. Vacancy has tightened slightly, by 0.2ppts HoH to 1.6%. Overall, Hakata has remained stable, and appears to have returned to normalcy, although some large companies appear to have upheld their hybrid work styles.

Looking ahead, JR Kyushu has unveiled plans to begin the construction of a new mixed-use building in 2023 with a floor plate size of 1,000 tsubo. The GFA of the building is expected to be more than 15,000 tsubo, and is slated to be completed in 2028.

Tenjin

Rents of Tenjin's investment-grade buildings also stayed flat over the past half-year at JPY21,000 per tsubo. However, vacancy has inched up by 0.3ppts HoH to 4.7%. The above-average vacancy stems primarily from Tenjin Business Center, which has about two floors totalling 1,400 tsubo of vacant space left. Nonetheless, vacancy in the submarket is still low overall.

In 2024, the major addition of the year, the Fukuoka Building, has floor plates of 1,400 tsubo and is expected to have rents of JPY32,000+ per tsubo, the most expensive in Fukuoka. Despite its high asking rents, it is rumoured to already be over half pre-leased. The building is in a prime location with large floor plates, establishing its prestige that should allow it to achieve a status as a trophy building.

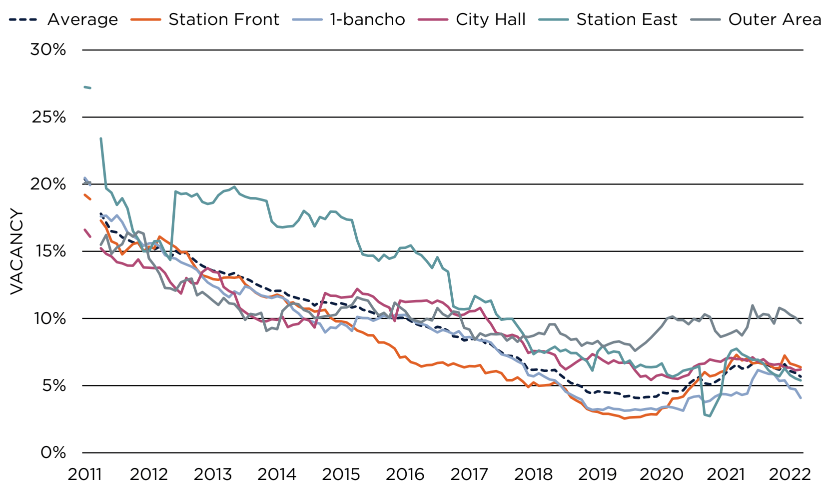
Outlook

The office market in Fukuoka has performed well overall. While the multiple new office additions have resulted in many movements, rents have been growing, and vacancy rates still remain low considering the consistent addition of new supply. Investment-grade rents have stayed stable over the past half-year, and vacancy has also contracted, showing the strength of the market. Vacancy rates are likely to inch up going forward with the large supply, while rents should stay stable or increase with new additions of quality buildings.

At the same time, there are some mixed signals and potential concerns over the upcoming supply. For instance, the 2022 Fukuoka Daimyo Garden City has seen lukewarm pre-leasing, and there are few rumours about pre-leased tenants of upcoming buildings in 2023, raising questions about the demand present. At the same time, the Fukuoka Building, which will be completed in 2024, is reportedly already more than 50% pre-leased. This observation reinforces the narrative that buildings with strong selling points are likely to be significantly more popular than those without. A close analysis of the performance of the three large new buildings in 2022 will be an important indicator of the market's condition.

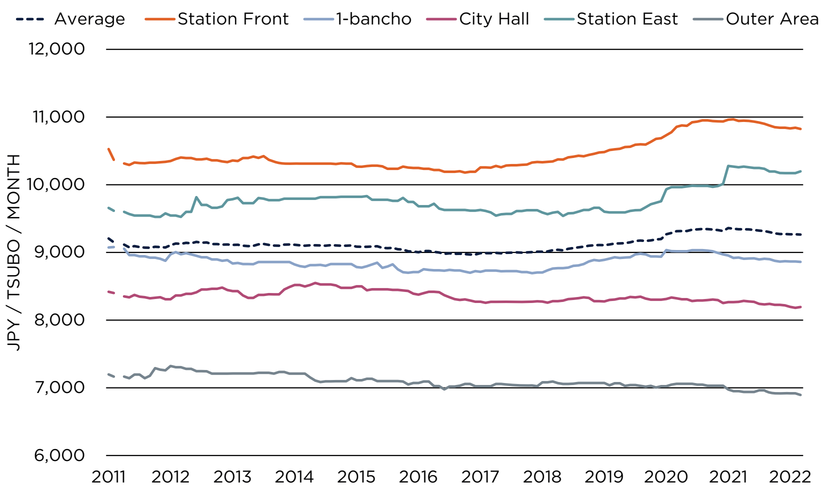
Nonetheless, prospects of the Fukuoka office market still look promising. Unlike its peers, Fukuoka's population has been steadily increasing even through the pandemic. Furthermore, the city has had low levels of remote work implemented, partially attributed to the shorter average commute time in the city. Both of these factors should help to nurture greater office demand. Going forward, the city will see greater revitalisation from the Tenjin Big Bang and Hakata Connected Projects.

GRAPH 16: Vacancy Rate in Sendai City by Area, 2011 to Q1/2022



Source Miki Shoji, Savills Research & Consultancy

GRAPH 17: Average Rent in Sendai City by Area, 2011 to Q1/2022



Source Miki Shoji, Savills Research & Consultancy

SENDAI CITY

Supply and Demand

In 2021, Sendai saw a notable amount of new supply – the largest since 2010, that was well received by the market. While 2022 looks to be a quiet year for Sendai, another year of large supply is forecast for 2023 with the addition of the Yodobashi Sendai Dai-ichi Building project in early 2023, and the Urbannet Sendai-Chuo Building in late 2023.

Vacancy

The all-grade vacancy rate in Sendai was 5.7% in Q1/2022, having gradually decreased from the previous half-year. While vacancy rates are still higher than pre-pandemic times, the improvement is an encouraging sign for the market, especially given the large supply in 2021. Moreover, the scarce supply in 2022 will make it easier for the current vacant stock to be absorbed.

All submarkets in Sendai saw an improvement in vacancy over the past half-year. Nonetheless, there remains some disparity between submarkets. For instance, the 1-bancho submarket has seen vacancy decline 1.8ppts HoH to 4.1%, and is the best performing in Sendai. In contrast, the Outer Area submarket still has vacancy levels close to double the city average, reportedly due to companies consolidating and reducing floor space.

Rent

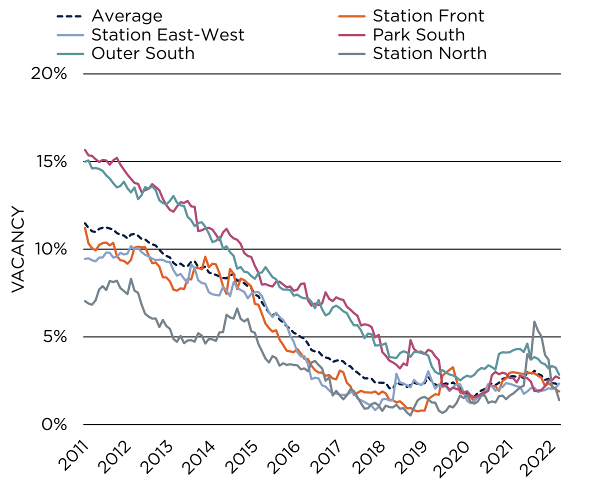
Rents in Sendai have seen a mild correction over the past half-year, decreasing 0.4% HoH to JPY9,250 per tsubo. Despite the decline, rents are overall still higher than pre-pandemic levels. Some small and medium sized buildings are reportedly having difficulty securing tenants and have had to resort to lowering rents in order to do so.

All submarkets have seen rents contract slightly over the past year. The Station Front and Station East submarkets remain the most expensive at JPY10,800 and JPY10,200 per tsubo, although the former also saw the largest annual contraction of 1.1%. Meanwhile Outer Area remains the most affordable at JPY6,900 per tsubo, having corrected 0.8% YoY.

Outlook

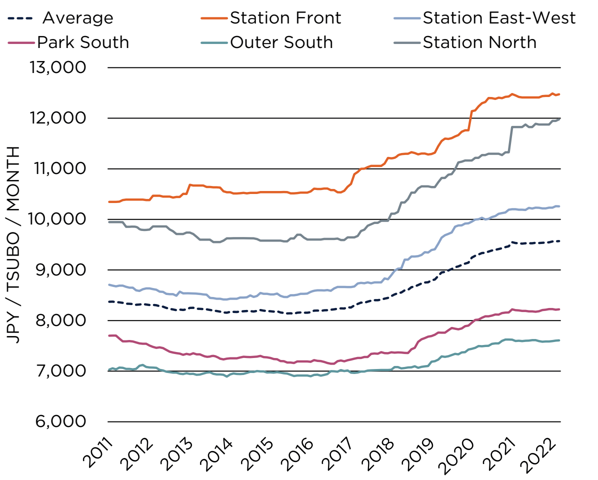
Sendai's rents have continued to contract over the past half-year, although corrections have been mild across all submarkets. Vacancies also remain mildly higher than pre-pandemic times, although they have been improving over the year. The low supply in 2022 is expected to improve the overall market in Sendai as more companies that previously owned their own office buildings from areas further away move to rental offices in Sendai. Going forward, vacancy is expected to remain stable, at around 5% or a little more. Rents should also be expected to see some increments due to the new quality supply to be added to the market.

GRAPH 18: Vacancy Rate in Sapporo City by Area, 2011 to Q1/2022



Source Miki Shoji, Savills Research & Consultancy

GRAPH 19: Average Rent in Sapporo City by Area, 2011 to Q1/2022



Source Miki Shoji, Savills Research & Consultancy

SAPPORO CITY

Supply and Demand

Sapporo's supply over the past few years has been steady, with an upward trend. In 2021, around 5,000 tsubo of NRA was added to the market, and a similar amount of supply is expected for 2022. However, in 2023, nearly 10,000 tsubo of NRA is forecast – the largest supply seen since 2006. The major building contributing to this supply is the D-LIFE PLACE Sapporo, which will be located next to the Sapporo subway station. Given the low vacancy rates and strong performance in Sapporo, the large supply may actually be welcome by the market.

Vacancy

All-grade vacancy in Sapporo has tightened by 0.7% HoH to 2.2% - the lowest levels seen since the start of the pandemic. The market appears to have been steadily absorbing the new supply added to the market, supported particularly by the opening of new call centres.

Most submarkets have seen vacancy decrease over the past year. For instance, the Station Front submarket saw vacancy tighten by 1.1ppts YoY to 1.9%. At the same time, the Park South submarket saw vacancy loosen slightly by 0.3ppts YoY. Nonetheless, all submarkets have vacancies of less than 3.0%, demonstrating the overall strength of Sapporo.

Rent

All submarkets in Sapporo have seen mild rental growth over the year. Overall, average rents in Sapporo have increased 0.5% YoY to close to JPY9,600 per tsubo. While the newer and more expensive buildings that are gradually being added to the market have increased rents, the low and tightening vacancy rates also indicate that there is sound demand for new office space, and this has also likely contributed to rental growth.

Rents in Station Front are still the most expensive at around JPY12,500 per tsubo. The second most expensive submarket, Station North, saw the largest increment in rents at 1.5% YoY to around JPY12,000 per tsubo. These locations are expected to see further increments in rental levels with the gradual addition of new office supply over the next few years.

Outlook

Looking at some increments in rent and improvements in vacancy, Sapporo's office market has been doing well despite the pandemic. Supply in 2022 and onward is likely to remain modest and should not overtly affect the market, and sufficient office demand is expected after the pandemic. Furthermore, the ballpark opening in 2023 and the Hokkaido Shinkansen scheduled for 2030 are likely to bolster business demand. Overall, the strong market conditions are likely to remain.

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