Japan - July 2023

SPOTLIGHT
Savills Research

Regional Japanese Office Markets

savills

Despite the current market stability, substantial new office supply may cause disruption

Summary

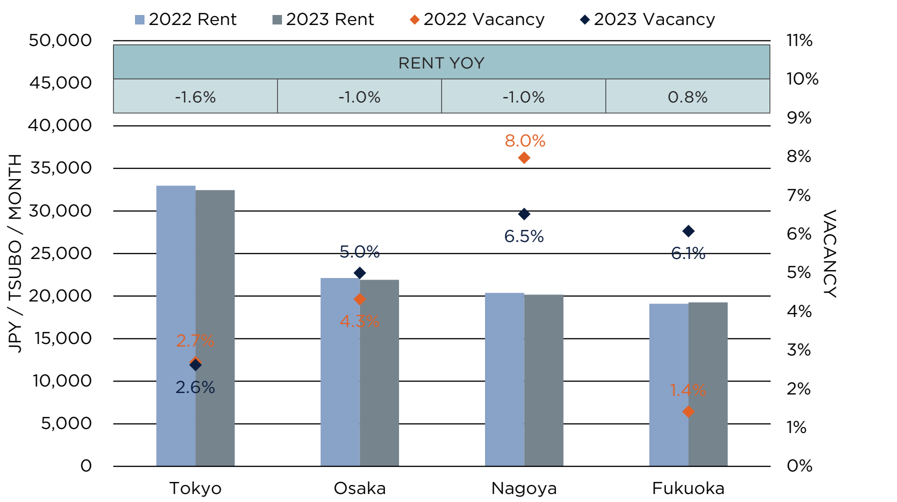
- Investment-grade offices have seen minor changes in rents, rising half-year-on-half-year (HoH) in Fukuoka and marginally contracting HoH in Osaka and Nagoya. Meanwhile, vacancy loosened in Osaka and Fukuoka, and tightened in Nagoya.
- All-grade office rental changes have been moderate across submarkets. Rents in Sapporo, Fukuoka, and Nagoya increased HoH, while Osaka and Sendai contracted marginally HoH.
- Cap rates for Grade A offices remained unchanged, and are relatively tight across all regional submarkets.
- Investment volumes in 2022 exceeded those of 2021 by 13%, while transactions have been slow so far in 2023. A few big-ticket transactions took place over the past half-year.
- New supply has been modest in Osaka and Nagoya in 2023, while Fukuoka has welcomed a significant amount of new office space.
- Large levels of supply are expected in Osaka and Fukuoka over the next few years, which might cause some fluctuations.

OVERVIEW

As of May 2023, COVID-19 was officially downgraded to the same status as the flu, which marks Japan's transition to a post-pandemic state. Accordingly, Japan's economy has undergone notable recovery, and there has been strong momentum in terms of corporate performance. Indeed, the quarterly Regional Economic Assessment conducted by the Bank of Japan (BOJ) in April 2023 indicated that most regional economies have been on an overall growth trajectory so far in 2023, which is a positive sign for office leasing in regional markets going forward.

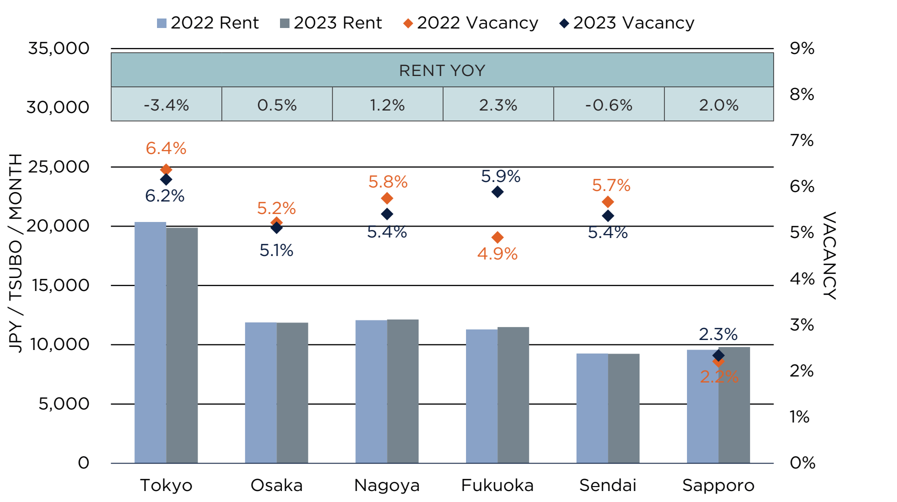
2023 is forecast to be a mixed year in terms of new regional office supply. Osaka will see relatively small amounts of new net rentable area (NRA), giving its respective submarkets breathing room to absorb available office space. That said, some concerns persist in Osaka in particular regarding the enormous amount of new office space slated for completion in 2024. Although Nagoya welcomed a modest amount of new supply, which assisted in tightening vacancy, the relatively large upcoming supply appears to outpace sluggish demand, which may cause some instability. Meanwhile,

GRAPH 1: Investment-grade Office Year-on-year (YoY) Performance, 1H/2023



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

GRAPH 2: All-grade Office YoY Performance, 1H/2023



Source Miki Shoji, Savills Research & Consultancy
*Market data as of March 2022 and March 2023.

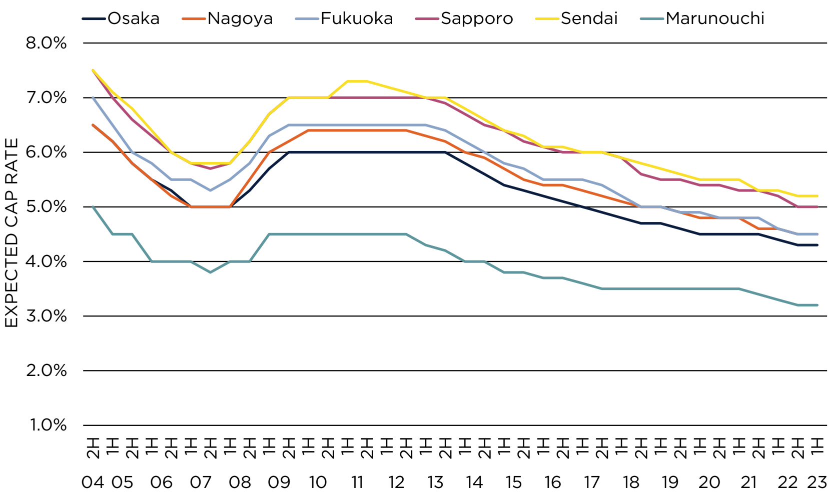
Fukuoka, Sendai, and Sapporo will all see relatively large amounts of new NRA arrive to the market in 2023. Although this may cause some disruptions, the favourable performance in each market so far should be a positive sign for the absorption of new offices going forward.

Overall, many owners across the markets have resorted to price corrections in order to attract tenants, which has created a sense of affordability. This has helped maintain stability in the market and generated further leasing demand.

For investment-grade offices, average rents were quite stable over the past half-year. Some mild contractions were experienced in Osaka and Nagoya due to lukewarm sentiment for new offices, while the completion of new expensive units caused a moderate uptick in Fukuoka.

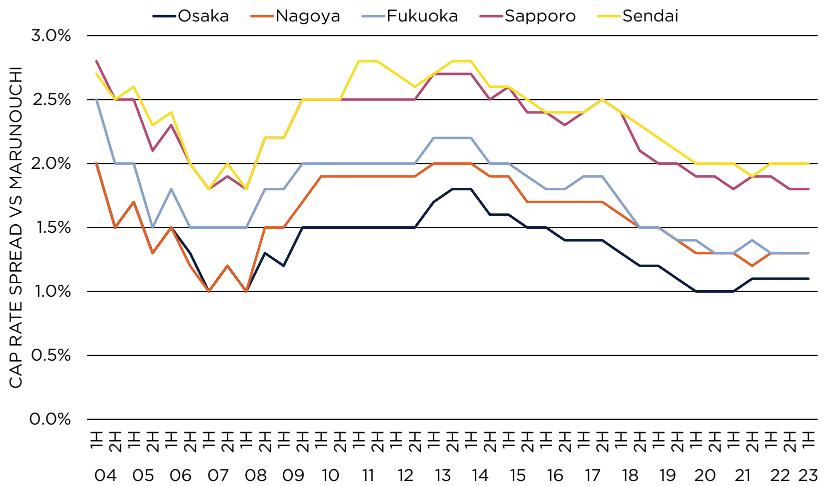
Stability has been a feature of regional office markets over the past half-year, especially given Japan's positive post-pandemic economic performance. New supply has been fairly limited overall in 2023, creating some breathing room to absorb existing vacant space. That said, many expensive or non-ideally located properties continue to underperform, while the large new supply slated over the coming years might impact the current equilibrium.

GRAPH 3: Expected Cap Rates for Grade A Offices, 2004 to 1H/2023



Source Japan Real Estate Institute, Savills Research & Consultancy

GRAPH 4: Expected Cap Rate Spreads (vs Marunouchi), 2004 to 1H/2023



Source Japan Real Estate Institute, Savills Research & Consultancy

Investment-grade vacancy loosened in Osaka and Fukuoka, while Nagoya experienced tightening as the limited new supply in 2023 has given the market breathing room to absorb existing vacant space.

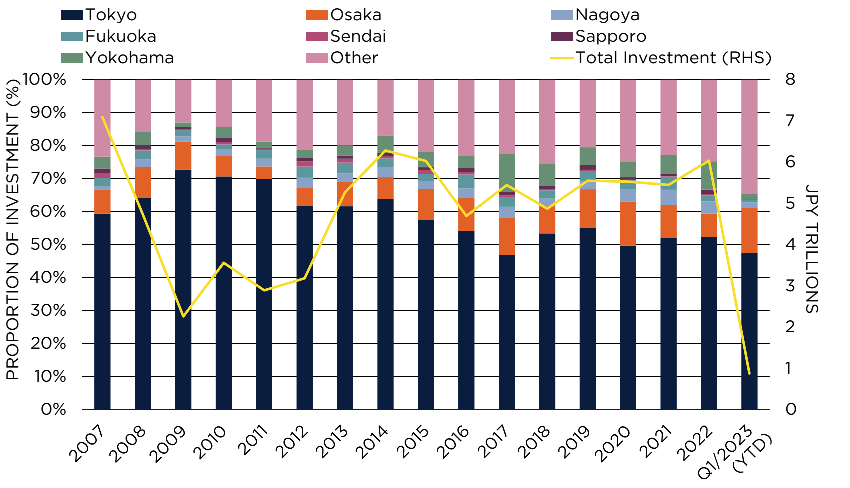
For the all-grade office market, average rents were largely stable over the past half-year. Sapporo and Fukuoka saw consecutive increments by 0.9% and 0.7% HoH, as did Nagoya, where all-grade rents increased by 0.2%. On the other hand, Osaka and Sendai experienced marginal contractions of 0.1%. Vacancy in the all-grade market was similarly stable over the past half-year. Vacancy in Fukuoka and Sendai loosened by around 0.8 percentage points (ppts) and 0.7ppts HoH, respectively, while other markets were either unchanged or tightened slightly.

REGIONAL INVESTMENT

According to the bi-annual investor survey conducted by the Japan Real Estate Institute in April 2023, expected cap rates in most regional markets remained unchanged. Prices remain elevated across most real estate sectors in Japan, and the compressed expected cap rates demonstrate that office assets in Japan are popular among investors.

According to transaction data from Real Capital Analytics (RCA), total investment nationwide was around 13% higher in 2022 compared to 2021. Similarly, transactions in the office sector rose moderately by around 2.5%. Although 2023 has had a slow start so far, current figures for Q1/2023 are preliminary, and are expected to increase as more transactions are confirmed.

GRAPH 5: Investment Volumes by Area for All Asset Types, 2007 to Q1/2023 (YTD)



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

Overall, appetite for office space in regional markets has been strong over the past half-year among domestic investors. The Nagoya market witnessed some significant transactions by J-REITs towards the end of 2022, including Global One REIT's acquisition of the Tomatsu Building for JPY17.3 billion. Meanwhile, Fukuoka REIT reportedly acquired part of Hakata FD Business Center for JPY14.1 billion.

Cross-border investment activity was firm in 2022, with around 30% of total office investment in Japan carried out by international investors, according to RCA. For instance, Goldman Sachs purchased the mixed-use office and retail property, Global Gate in Nagoya from Daiwa House Industry for a reported JPY50 to 60 billion, which was by far the largest regional office transaction over the past half-year.

However, the BOJ is expected to gradually normalise monetary policy due to the record inflationary environment. Indeed, interest rates have already increased noticeably, which has made international investors more cautious. In addition, the office sector has been performing poorly overseas, especially in the US, and the momentum by international players looks to remain subdued. Hence, there will likely be some pessimism surrounding the sector for the meantime.

OUTLOOK

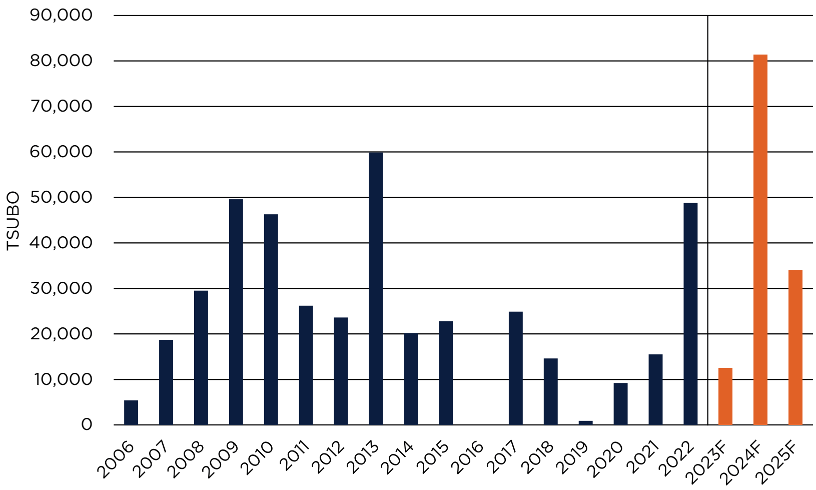
Most regional office markets are similar in their stable and firm performance over the past half-year. Meanwhile, certain markets share some issues in absorbing recently completed new supply, especially offices with high rents relative to their respective market. That said, given the improving economic performance accompanying Japan's transition to a post-pandemic society, and the limited rates of remote work seen in regional markets, correctly-priced and conveniently-located offices should be gradually absorbed.

Looking ahead, many observers have concerns about the potential disruptions caused by large new supply slated for completion over the coming years. All surveyed markets will welcome relatively large amounts of new office space in 2024, which will likely contribute to an uptick in not only rents but also vacancies.

Furthermore, noticeable levels of vacancy are seen in some new properties that are priced high for the market. As such, there appear to be insufficient potential tenants, and those properties remain vacant. This situation may be more observable especially in Osaka, which will welcome a number of new developments, particularly around Umeda station. Therefore, despite most markets demonstrating stable performances, observers may see some fluctuations over the coming few years.

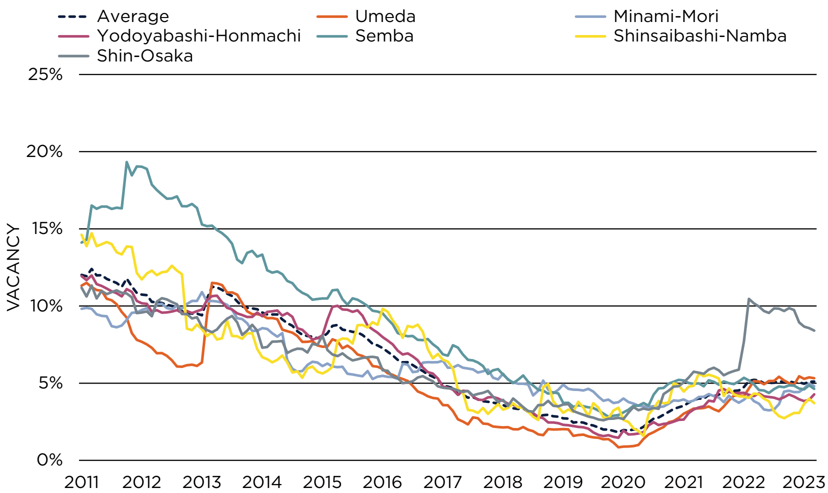
Overall, all markets remain stable, and are likely to see further recovery. Rental adjustments observed thus far give prospective tenants the sense of affordability, which leads to leasing demand and market stability. That said, Osaka and Nagoya may not be that fortunate given the large amount of expensive supply arriving to the market in 2024.

GRAPH 6: New NRA Office Supply in Osaka City, 2006 to 2025F



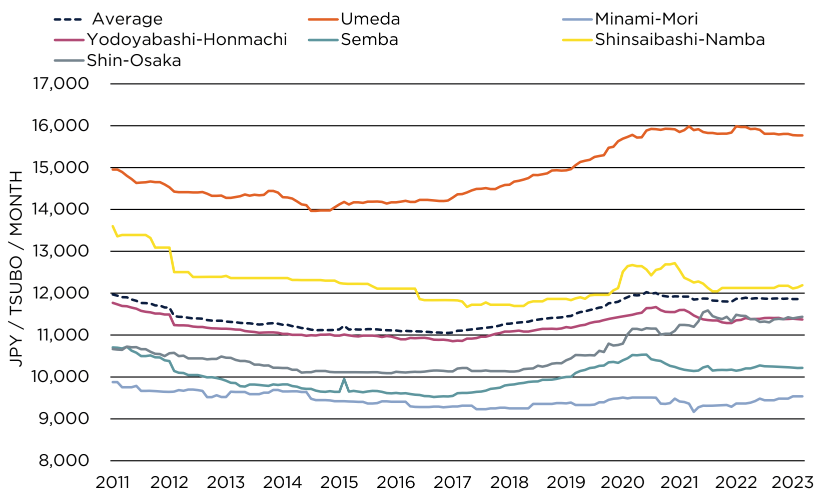
Source Sanko Estate, Savills Research & Consultancy

GRAPH 7: Vacancy Rate in Osaka City by Area, 2011 to Q1/2023



Source Miki Shoji, Savills Research & Consultancy

GRAPH 8: Average Rent in Osaka City by Area, 2011 to Q1/2023



Source Miki Shoji, Savills Research & Consultancy

OSAKA CITY

Net Rentable Area (NRA)

2022 was a busy year for completions in Osaka, with around 50,000 tsubo of new office space arriving to the market. Regardless, the market only witnessed minor fluctuations, which demonstrates the appetite for new office space in the market.

The forecast for new office supply in 2023 is quite low, and only a few completions have been observed in the Namba and Honmachi submarkets. This should provide the market more time to absorb the large supply from 2022. On the other hand, concerns persist regarding the enormous new supply slated for completion in 2024. Around 80,000 tsubo of new NRA will be added mainly around the Umeda station area, in addition to 35,000 tsubo in 2025, which may cause significant disruption to the market, especially due to the high target rents.

Vacancy

Investment-grade vacancy rates loosened slightly by 0.2ppts HoH to 5.0% in 1H/2023. The Shin-Osaka submarket continues to contribute to most of the vacancy, with most newly constructed office buildings in the submarket displaying high levels of vacancy. Elsewhere, vacancy remains fairly tight in most other submarkets, aside from a recently completed development in Namba with high levels of vacancy.

All-grade vacancy rates stayed flat over the past half-year at 5.1%, and there was little variation at the submarket level. Vacancy remains relatively high in Shin-Osaka, but has since continued to stabilise and vacancy has decreased by around 1.3ppts HoH to 8.4%. Meanwhile, the completion of Parks South Square may have resulted in moderate loosening in the Namba submarket over the past half-year by 1.0ppts to 3.7%.

Rent

Rents in investment-grade offices fell by a moderate 0.1% HoH to JPY21,900 per tsubo. This slight contraction was caused by some weakish sentiment, and overall the investment-grade market appears to be relatively stable.

All-grade rents declined marginally at 0.1% HoH to JPY11,850 per tsubo. Slight rental contractions were experienced across the central Umeda, Honmachi, and Semba submarkets, where rents fell 0.3% HoH uniformly. Nevertheless, Umeda remains the most expensive submarket by a

TABLE 1: Osaka Investment-grade Offices

	1H/2023	HOH	YOY
Rent	21,900	-0.5%	-1.0%
Vacancy	5.0%	+0.2ppts	+0.7ppts
Top Rent	38,000	0	0

Source Savills Research & Consultancy

considerable margin, and the scale of upcoming new developments suggests there is confidence in the strength of leasing demand in the area. On the other hand, Shin-Osaka average all-grade rents increased by 0.5% HoH to JPY11,450.

Umeda

Rents for investment-grade offices in the Umeda submarket contracted by 0.6% HoH to JPY24,900 per tsubo. Meanwhile, investment-grade vacancy was largely unchanged. So far, the large Osaka Umeda Twin Towers South has mostly been filled, which demonstrates the strength of the submarket. The absence of large-scale projects this year should provide some breathing room for the market to absorb existing vacancies, while the demand for smaller-scale office space by tenants is sound, and should allow vacancy to tighten throughout the year.

Going forward, Umeda will welcome the 35,000 tsubo Grand Green Osaka (formerly Umekita 2nd Project), and the 20,000 tsubo JP Tower Osaka (formerly Umeda 3-Chome Project), among others in 2024. These developments will transform the station area, and will likely attract many businesses to the area. That said, there are concerns that the market will not be able to keep up with the massive influx of supply, and observers should anticipate some fluctuations in 2024.

Yodoyabashi-Honmachi

Rents for investment-grade offices in the Yodoyabashi-Honmachi submarket increased 2.1% HoH to JPY23,700 per tsubo in 1H/2023. Meanwhile, investment-grade vacancy loosened by 1.5ppts HoH to 5.3%. That said, 2023 is looking to be a relatively quiet year for the submarket, and the only completion of moderate scale has been Honmachi Garden Terrace, which appears to have only caused minor disruptions in the submarket, and observers should not anticipate any major changes this year.

However, development activity will accelerate going forward, particularly with the addition of the 7,000 tsubo Urbannet Midosuji Building and the 30,000+ tsubo twin Yodoyabashi Station redevelopment projects, slated for completion in 2024 and 2025, respectively. Concerns persist regarding potential disruptions in the market, especially due to the competition from large modern developments in the nearby Umeda submarket.

Shin-Osaka

Investment-grade rents for offices in the Shin-Osaka submarket contracted moderately at 1.3% HoH to JPY18,900 per tsubo. Although 2022 was a busy year for completions in Shin-Osaka, the average investment-grade vacancy rate tightened by 2.9 ppts HoH to 11.7% in 1H/2023, but remains elevated. Many new office developments still have high levels of vacancy, which may see further rent reductions and free-rent periods going forward.

That said, despite the grim situation in the submarket, vacancy decreased HoH in the all-grade market, with particular interest seen towards smaller offices among tenants. Going forward, another development is scheduled for the Shin-Osaka submarket in 2024, which does not look that promising.

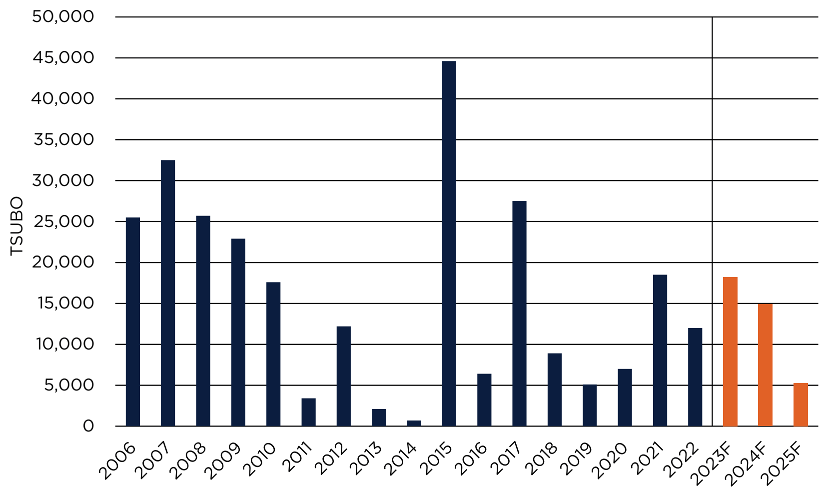
Outlook

Overall, the Osaka office market has been firm over the past half-year, and most new additions from 2022 are gradually being absorbed. Furthermore, 2023 is predicted to be a quiet year for Osaka, with just over 10,000 tsubo of new office supply scheduled to be added to the market. This should allow each submarket more time to absorb existing vacant supply and bring greater stability in the coming year.

However, some concerns persist in the market. Shin-Osaka still appears to be struggling with high levels of vacancy, and will even see a new development arrive to the market early next year. Meanwhile, the Umeda submarket will be under the spotlight in 2024. Although the submarket absorbed Osaka Umeda Twin Towers South in 2022 uneventfully, investors should note that the scale of upcoming supply in 2024 will likely result in some disruptions in the submarket. Moreover, incoming office supply is set to be very expensive, which does not bode well for smooth absorption.

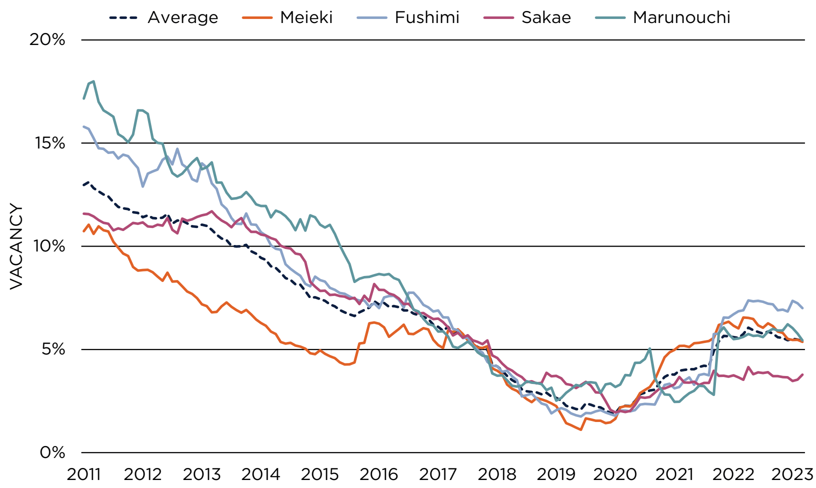
Overall, the market remains sound and rents and vacancies look to increase slightly going forward due to state-of-the-arts supply.

GRAPH 9: New NRA Office Supply in Nagoya City, 2006 to 2025F



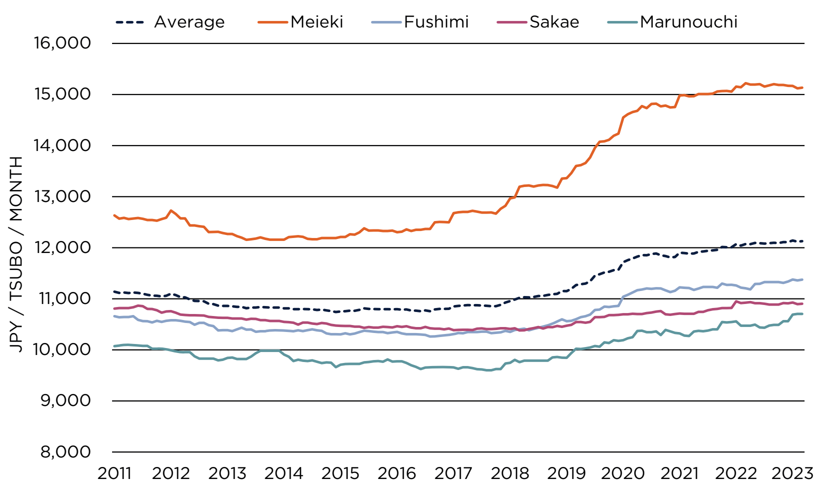
Source Sanko Estate, Savills Research & Consultancy

GRAPH 10: Vacancy Rate in Nagoya City by Area, 2011 to Q1/2023



Source Miki Shoji, Savills Research & Consultancy

GRAPH 11: Average Rent in Nagoya City by Area, 2011 to Q1/2023



Source Miki Shoji, Savills Research & Consultancy

NAGOYA CITY

NRA

The past half-year has been relatively quiet in terms of new office supply, which has contributed to stability in the Nagoya office market. The market appears to have continued absorbing recent supply. That said, some vacancies persist at the property level and several new offices completed in recent years are still struggling with high levels of vacancy.

Nagoya will welcome around 18,000 tsubo of new NRA in 2023, and 15,000 tsubo in 2024. The most notable addition will be the 10,000 tsubo Chunichi Building, slated for completion in July 2023 in the Sakae submarket, which has received strong attention overall. Elsewhere, a few moderately large developments will be completed around late 2023 in the Meieki submarket, including the 3,800 tsubo Enishio Meieki and the 3,200 tsubo Frontier Meieki developments, which have raised some concerns for the market. Indeed, some potential tenants appear reluctant to pay the moderately high target rents of JPY20,000 per tsubo, so pre-leasing has been notably slow in places.

Vacancy

Investment-grade office vacancy in Nagoya has tightened further by 1.2ppts HoH to 6.5%. This was mainly due to the gradual absorption of newly completed offices in the market, while vacancy remained fairly tight across the market. Property-level performance varied noticeably, and while the leasing performance of Nagoya Building Sakura-kan has seen some progress, other new buildings still exhibit high levels of vacancy.

All-grade market vacancy tightened by 0.4ppts HoH to 5.4%, and all submarkets appear to have performed well. The Meieki and Marunouchi submarkets saw some tightening, with vacancy decreasing by 0.7ppts and 0.6 ppts HoH, respectively, to 4.5% in both submarkets. Overall, while vacancy in Nagoya has been gradually improving, there is still some way to go. This will largely depend on Nagoya's economic recovery and the level of corporate investment by conservative companies in Nagoya.

Rent

In 1H/2023, investment-grade office rents contracted moderately by 0.4% HoH to JPY20,200 per tsubo. Some incoming properties appear to have lowered rents

TABLE 2: Nagoya Investment-grade Offices

	1H/2023	HOH	YOY
Rent	20,200	-0.4%	-1.0%
Vacancy	6.5%	-1.2ppts	-1.5ppts
Top Rent	35,000+	0	0

Source Savills Research & Consultancy

slightly in order to attract tenants, given that many tenants have been reluctant to pay ambitious target rents of many new developments. That said, rents remained unchanged for a majority of other offices in the market, and appears to be stable.

Meanwhile, all-grade rents increased slightly to JPY12,150 per tsubo, an increment of 0.2% HoH. Although Meieki remains the most expensive submarket in Nagoya, it was the only submarket to experience a decline in rents, which fell by 0.5% HoH. The Sakae market has continued to be relatively stable, with rents growing marginally at 0.1% HoH to JPY10,900 per tsubo. The addition of the Chunichi building will likely contribute to rental growth and make the area more attractive.

Meieki

Meieki's investment-grade office rents contracted by 1.5% HoH to JPY27,100 per tsubo, which stemmed from some older buildings which reduced rents. Meanwhile, investment-grade vacancy tightened by a notable 1.8ppts HoH to 3.2%. Overall, Meieki appears to have been making decent progress in absorbing existing vacant office space, particularly in Nagoya Building Sakura-kan.

Going forward, the submarket will welcome a few large developments, including the 3,800 tsubo Enishio Meieki and 3,200 tsubo Frontier Meieki in 2023, as well as the 4,000 tsubo 2nd Nagoya Sanco Building in 2024. Despite the sizeable increase in NRA, Meieki's fundamentals look strong, and leasing demand appears sufficient to gradually absorb the new supply.

Fushimi and Marunouchi

Investment-grade office rents in both the Fushimi and Marunouchi submarkets were unchanged over the past half-year, at JPY18,500 per tsubo and JPY16,200 per tsubo, respectively in 1H/2023. Meanwhile, investment-grade vacancy loosened moderately in Fushimi by 0.9ppts to 16.2%, while Marunouchi tightened 2.3ppts HoH to 7.0%.

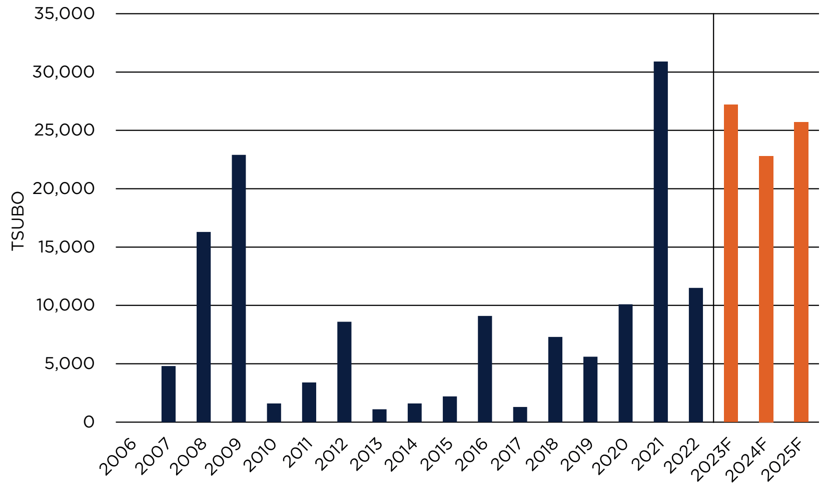
Indeed, there were few changes in both submarkets, and observers can expect minimal changes over the coming year. The only new completion in 2023 was the Sanko Nagoya Nishiki Building in Fushimi. Although some offices have experienced slow leasing progress, vacancy is expected to gradually stabilise over the coming year, especially due to the relative affordability of the submarket compared to its counterparts.

Outlook

There were few changes in the Nagoya office market overall in 1H/2023. New supply has been modest, which has afforded the market more time to absorb existing vacant space. However, while the Chunichi Building has experienced sound pre-leasing, other new developments appear to go slowly. Indeed, target rents for new incoming offices are rumoured to be relatively high, which will likely push average market-wide rents and vacancy up going forward, as well as deter potential tenants.

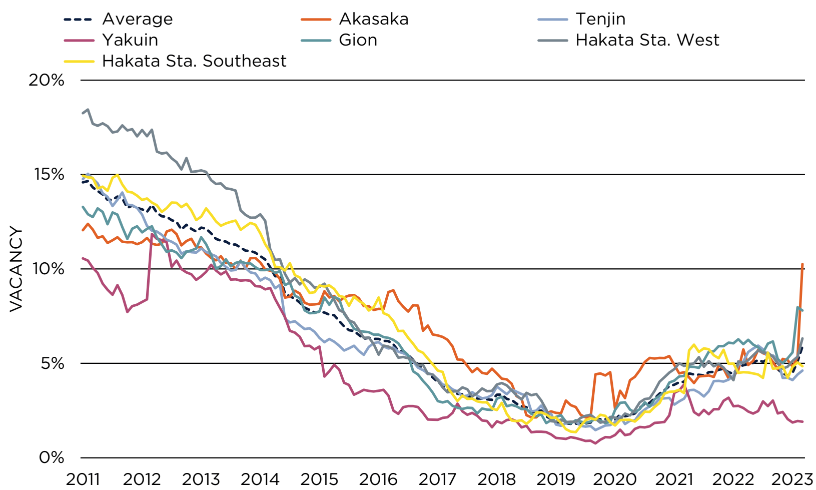
Vacancy has tightened moderately over the past half-year, and the economic outlook for Nagoya looks strong. However, many companies in Nagoya are conservative and appear slow in expanding their office plans, so the leasing of available office plates should be gradual. Although leasing demand will likely remain on the back of the economic recovery in Nagoya, the supply of new office space looks to outpace demand. Hence, the market will likely experience slight increases in rents, in addition to slight vacancy loosening due to new incoming additions.

GRAPH 12: New NRA Office Supply in Fukuoka City, 2006 to 2025F*



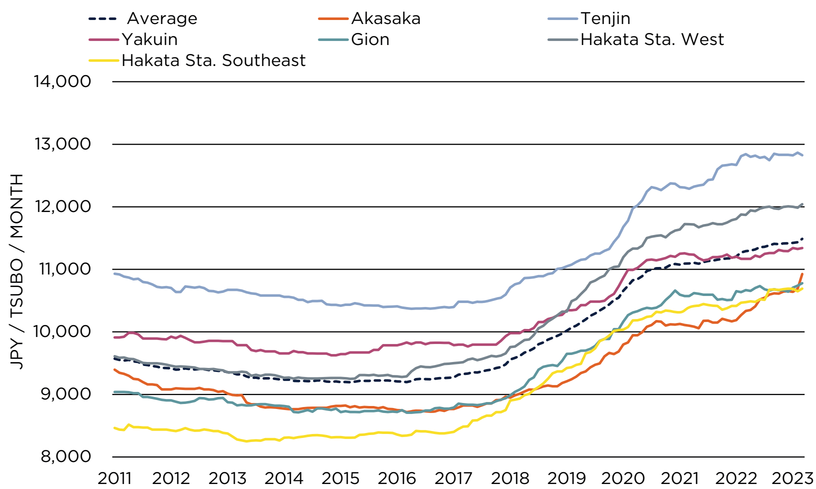
Source Sanko Estate,Savills Research & Consultancy

GRAPH 13 Vacancy Rate in Fukuoka City by Area, 2011 to Q1/2023



Source Miki Shoji, Savills Research & Consultancy

GRAPH 14: Average Rent in Fukuoka City by Area, 2011 to Q1/2023



Source Miki Shoji, Savills Research & Consultancy

FUKUOKA CITY

NRA

Fukuoka appears to have mostly absorbed the new supply since 2022, but there have been some hiccups with supply in 2023, such as Fukuoka Daimyo Garden City, which remains largely vacant. That said, Fukuoka's economy is anticipated to perform well in 2023, and the return of inbound tourists will also help. As such, the improving business sentiment should help the market to gradually absorb incoming supply.

A large amount of new office supply is forecast, with approximately 25,000 tsubo of new supply to be added annually in the next few years. Upcoming developments will mainly be concentrated in the Tenjin and Hakata submarkets.Many upcoming developments in Tenjin appear to have target rents of JPY30,000 per tsubo, and there are concerns that there is insufficient demand among tenants to fill large office space at such a high price point.

Vacancy

Investment-grade vacancy increased significantly by 3.9ppts HoH to 6.1%. This loosening stems from a few new additions to the Fukuoka office market. For instance, the 9,000 tsubo Fukuoka Daimyo Garden City came to the market with large amounts of vacant space, and Hakata Ekimae 4-Chome Parkside is also in a similar situation.

The all-grade market saw average vacancy rates rise by 0.8ppts HoH to 5.9%. Most submarkets only saw minor fluctuations, with the exception of the Akasaka and Daimyo submarket, where Fukuoka Daimyo Garden City is located and vacancy jumped to 10.3%, an increment of 5.2ppts HoH. That said, the market overall is likely to gradually absorb existing vacant space going forward.

Rent

In 1H/2023, investment-grade rents in Fukuoka rose slightly to JPY19,300 per tsubo, an increment of 1.0% HoH. Overall, there was little fluctuation in terms of rents at the property level, and the market appears to be relatively stable. The slight rental increment is attributed to the addition of a number of new offices with above average rents.

All-grade rents increased by 0.7% HoH to JPY11,500 per tsubo, which amounts to a new record level for all-grade rents in Fukuoka. The greatest increment was again experienced in Akasaka and Daimyo, where rents increased 2.9% HoH, due to the

TABLE 3: Fukuoka Investment-grade Offices

	1H/2023	HOH	YOY
Rent	19,300	1.0%	0.8%
Vacancy	6.1%	+3.9ppts	+4.7ppts
Top Rent	30,000	0	0

Source Savills Research & Consultancy

addition of Fukuoka Daimyo Garden City. Tenjin retains the most expensive rents in Fukuoka at JPY12,800 per tsubo, which contracted by 0.2% over the past half-year.

Hakata

Rents of investment-grade buildings in Hakata decreased marginally by 0.4% HoH to JPY20,600 per tsubo, due to the addition of a few new developments with slightly below-average rents in the submarket. Overall, rents range between JPY15,000 and JPY27,000+ per tsubo. Meanwhile, vacancy has increased to 4.3%.

Overall, the Hakata submarket has been tight and relatively stable, and new supply looks to be well received. There are a few office developments of notable scale in the pipeline for Hakata from 2023, including an office with 3,500 tsubo of NRA in 2024, which appears to have secured over 50% pre-leasing.

Tenjin

Rents of Tenjin's investment-grade buildings have increased moderately by 1.6% HoH to JPY21,600 per tsubo, which was largely due to the opening of Fukuoka Daimyo Garden City[1]. However, the development remains largely vacant, which caused a notable increase in average vacancy in the Tenjin submarket to 15.9%, an increase of 11.9% HoH.

Despite late 2023 looking to be a quiet year in terms of large-scale completions in the Tenjin submarket, completions are scheduled to pick up going into 2024. The 14,000 tsubo Fukuoka Building has drawn significant attention, and pre-leasing appears to be encouraging. The submarket will also welcome the Tenjin 1-chome North 14-ban Gaiku Building and the mixed-use Sumitomo Life Fukuoka Building developments in 2025, which look to change the landscape of the submarket.

Outlook

Overall, Fukuoka's office market has performed well over the past half-year, and the market appears to have absorbed a large amount of new office supply from 2022. This was supported by the economic recovery seen in Kyushu, and the strong performance of call centre businesses in Fukuoka, which typically target more moderately priced units.

1 Under Savills Research & Consultancy data, Fukuoka Daimyo Garden City is classified within the Tenjin submarket, which may differ from other third-party data.

Looking forward, there are some persisting concerns over potential fluctuations in the market with the arrival of multiple new pricey office developments in 2024 and 2025. These new developments in Tenjin will likely aim at high rents of JPY30,000+ per tsubo. As such, there appear to be insufficient tenants that are willing to pay the expensive rents for incoming large floors. Although average rents are likely to rise across the market due to these new additions, many of these expensive developments will likely take time to attract tenants, and vacancy will also be higher for the meantime.

That said, the strength of leasing activity will largely depend on the location and price point of new developments. Properties coming to the market with rents that are in line with current market expectations are likely to perform well given Fukuoka's favourable economic conditions and relatively tight markets. Furthermore, many new developments with rents of around JPY30,000 per tsubo make other offices look more affordable by comparison, leading to some office demand in these offices. Overall, the Fukuoka market looks to remain tight and stable, regardless of the relatively large new supply.

SENDAI CITY

Supply and Demand

Although 2022 was a relatively quiet year in terms of new supply, 2023 is slated to see the highest level of new office space arrive to the market since 2008, which may cause some noticeable fluctuations in terms of vacancy and rents over the year.

2023 will see more than 40,000 tsubo of gross floor area (GFA) added to the market, with additions including the Yodobashi Sendai Daiichi Building in March, and the Urbannet Sendai-Chuo Building in November. These new developments are mainly concentrated in the Station Front and Station East submarkets, which will be the focus of any fluctuations over the coming year.

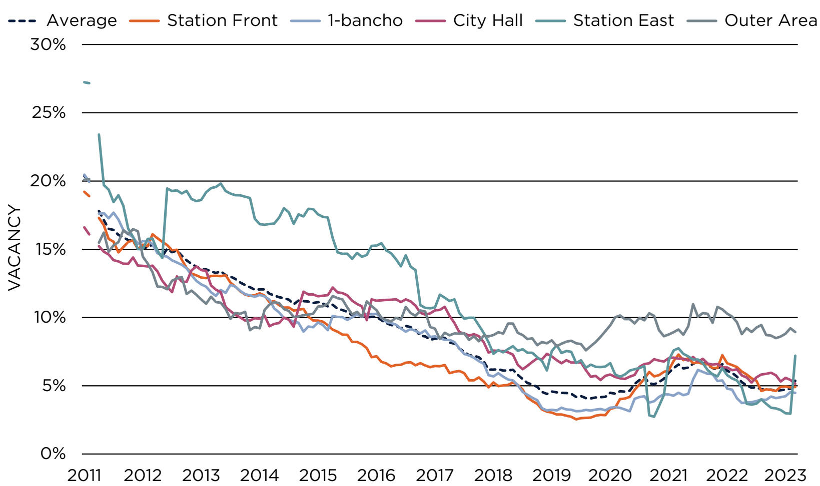
Vacancy

The all-grade vacancy rate in Sendai was 5.4% in Q1/2023, following a slight increment around the beginning of the year. Sendai experienced the second-largest increase in all-grade vacancy among the surveyed markets at 0.7ppts HoH, following the notable tightening in the previous period. This may increase as more new supply arrives to the market over the year.

Most submarkets experienced some moderate loosening in Q1/2023. Vacancy rates in the Station East submarket jumped to 7.2% in Q1/2023, an increase of 3.5ppts HoH, due to the Yodobashi Sendai Daiichi Building. The submarket had few pre-existing large-scale office buildings, so there was some concern that the sudden influx of new supply may destabilise the market temporarily.

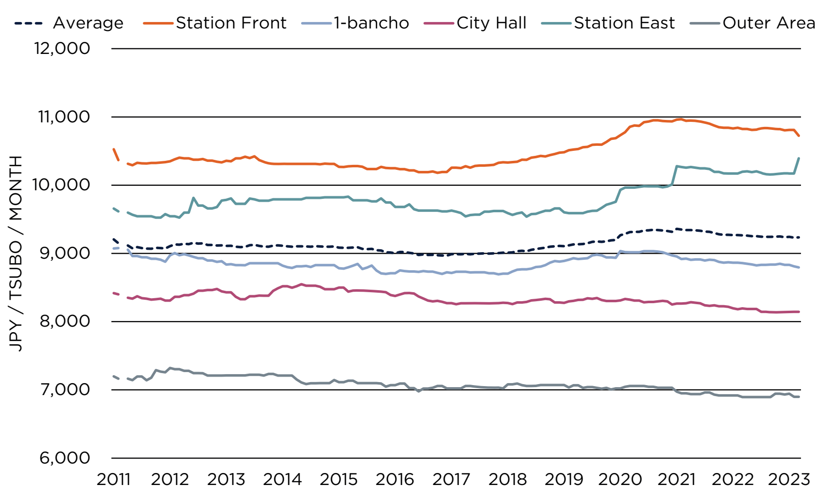
The Outer Area submarket also saw vacancy loosen at 0.2ppts HoH to 8.9%, the highest levels in the Sendai market. Meanwhile, vacancy hovers around the more moderate 5% level in the Station Front, Ichiban-cho, and City Hall submarkets.

GRAPH 15: Vacancy Rate in Sendai City by Area, 2011 to Q1/2023



Source Miki Shoji, Savills Research & Consultancy

GRAPH 16: Average Rent in Sendai City by Area, 2011 to Q1/2023



Source Miki Shoji, Savills Research & Consultancy

Rent

Stability in average all-grade office rents persisted over the past half-year in Sendai, with rents contracting marginally 0.1% HoH to JPY9,250 per tsubo.

The Station Front and Station East submarkets remain as the most expensive submarkets at JPY10,850 and JPY10,150 per tsubo, and saw a decline of 1.0%, and an increase of 3.2%, respectively. The large-scale modern Yodobashi Sendai Daiichi Building project added around 3,000 tsubo of NRA to the Station East submarket, and likely had an outsized impact in raising average rents in the submarket. This may also occur in the Station Front submarket with the completion of the Urbannet Sendai-Chuo Building in November 2023.

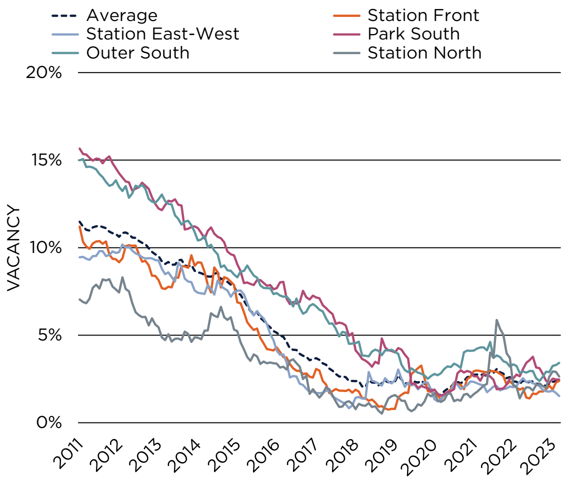
Rents in the Outer Area submarket remained unchanged over the past half-year at JPY6,900 per tsubo, which are the lowest in Sendai. Since the submarket is not forecast to see any new office supply introduced in 2023, observers will not likely expect major rental fluctuations for the meantime.

Outlook

Although conditions remain favourable overall in Sendai, the onset of new supply in the market has contributed to some fluctuations. Indeed, vacancy loosened notably around the station area, which may take some time to stabilise as the new supply is absorbed.

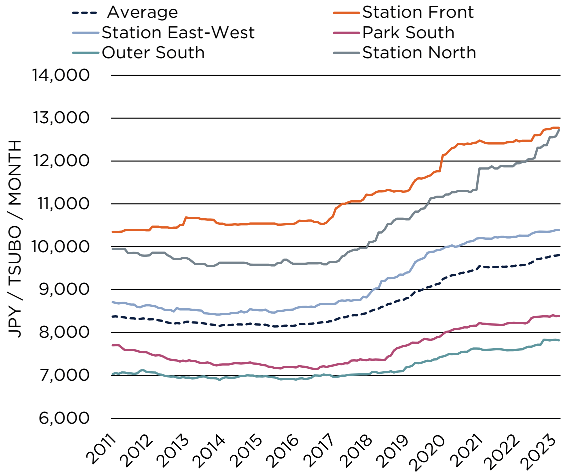
Going forward, high levels of new office space are scheduled for completion in Sendai's central submarkets in 2023, which may further contribute to heightened vacancy in the market. Although the introduction of high-quality office space has contributed to some upward movement in rents in the Station East submarket, further rental increments will largely depend on business sentiment.

GRAPH 17: Vacancy Rate in Sapporo City by Area, 2011 to Q1/2023



Source Miki Shoji, Savills Research & Consultancy

GRAPH 18: Average Rent in Sapporo City by Area, 2011 to Q1/2023



Source Miki Shoji, Savills Research & Consultancy

SAPPORO CITY

Supply and Demand

The new supply appears to have caused minimal disruption to the Sapporo office market. 2023 will see a significant volume of new office space concentrated around the station area, with approximately 10,000 tsubo of NRA scheduled for completion.

The largest upcoming developments will be the Sapporo North 6 West 1 Office Project in the Station North submarket, scheduled for completion in August, in addition to D-LIFE PLACE Sapporo in the Station Front submarket in May. Overall, rents remain high and vacancy is tight in both submarkets, demonstrating the strong condition of the Sapporo office market, and raising expectations that the new supply will be absorbed with minimal instability.

Vacancy

All-grade vacancy in Sapporo remained stable, increasing marginally by 0.1ppts to 2.3%. Despite some new additions to the market in 2022, overall vacancy saw little fluctuation in Sapporo, and remains the lowest among the surveyed cities by a considerable margin.

There was some moderate disparity between submarkets in terms of vacancy. Both the Station East-West and Park South submarkets saw some tightening by 0.6ppts, and the Station East-West submarket reached the notably low levels of 1.5%. On the other hand, slight loosening was observed in other submarkets, although this should not be a cause for concern. Overall, given the strong appetite for new office space, especially with a number of relocations that have recently taken place by IT firms and call centres, the absorption of new office space is expected to proceed smoothly.

Rent

All submarkets in Sapporo have seen some gentle rental growth over the past half-year, and average all-grade rents increased by 0.9% to JPY9,800 per tsubo.

The Station North submarket saw the largest HoH rental increment at 3.3% to JPY12,700 per tsubo. The submarket looks to welcome the Sapporo North 6 West 1 Office Project in 2023, which is likely to sustain this increasing trend. Similarly, the Station Front submarket experienced a 1.3% HoH increase in rents, and remains the most expensive submarket at JPY12,800 per tsubo. With demand for business relocations remaining tight for a while, observers should anticipate further gentle rental growth going forward.

Outlook

Overall, Sapporo has continued its favourable performance over the past half-year, and its strong fundamentals will likely support further rental growth in 2023. The market had few issues absorbing new supply in 2022, and the current level of demand for relocations and office space suggests that the new supply slated for completion in 2023 should cause little fluctuation in terms of vacancy, while contributing to some further growth in asking rents, particularly around the Sapporo station area. 2024 and 2025 are also slated to deliver a large supply of new office space, which will transform Sapporo towards 2030 with the completion of the Hokkaido Shinkansen extension.

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