Japan - July 2024

SPOTLIGHT
Savills Research

Regional Japanese Office Markets

savills

Positive trajectory overall, though temporary weakness may be triggered by large supply

Summary

- Investment-grade offices have seen moderate improvements in rents, rising half-year-on-half-year (HoH) in Osaka, Nagoya, and Fukuoka. Vacancy varied slightly, tightening in Nagoya and Fukuoka, while loosening marginally in Osaka.
- All-grade office rental changes remained on a positive trajectory over the past half-year, while vacancy remained stable, with a number of instances of tightening observed.
- Grade A office cap rates tightened marginally in Nagoya, Sendai, and Sapporo in 1H/2024, and were unchanged elsewhere. Overall, cap rates remain relatively tight across all regional submarkets.
- Overall investment volumes in 2023 lag those of the same period in 2022 by nearly 10%, while the office market saw a greater decline in transaction volumes by 35% over the year.
- 2024 will be a major year for new supply, with several large, mixed-use developments slated for completion, notably in Osaka, Fukuoka, and Sapporo.
- Large amounts of new supply will be added to the Osaka and Fukuoka markets in 2024 and 2025, with some observers concerned about potential fluctuations. That said, strong business sentiment has also contributed to sound pre-leasing activity.

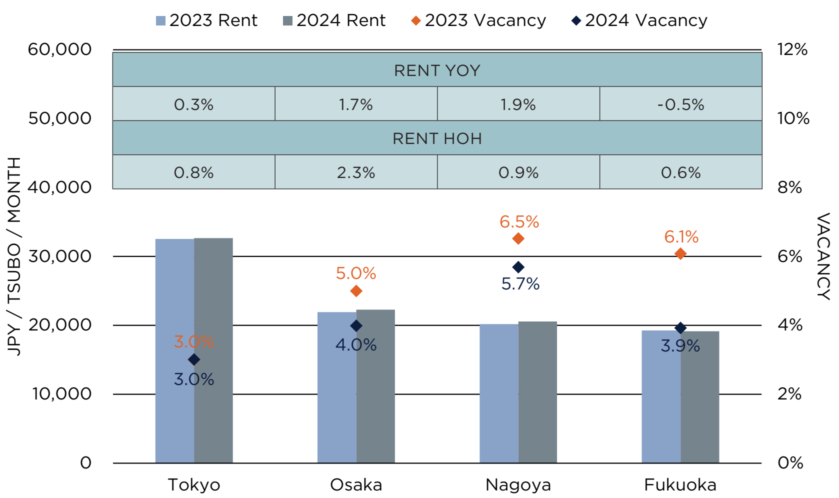
OVERVIEW

Many Japanese companies have enjoyed record profits in 2023 and 2024, and business sentiment is notably positive. Top global players in niche markets and services focusing on inbound businesses seem to be performing strongly. Indeed, there is a meaningful connection between corporate performance and office rental growth, which should be supportive for regional office markets in Japan.

Many firms are reassessing their office needs and carrying out long overdue renovations and relocations. Moreover, a large proportion of firms across Japan appear to be gradually phasing out flexible work arrangements, and are therefore focused on providing quality and flexible workspaces that support communication and improve wellbeing in order to encourage workers back to the office, especially in the current tight labour market. Hence, modern, mixed-use office developments that can support such new workstyles are enjoying significant attention, despite slightly more premium rental levels. Properties with strong ESG certifications appear to be especially attractive.

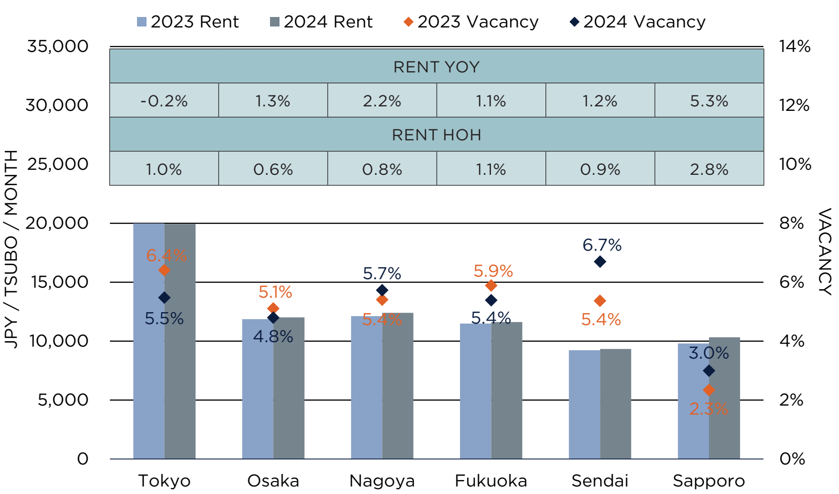
Overall, 2024 will be another busy year for office completions across many regional cities in Japan. Osaka, Nagoya, and Fukuoka will all welcome elevated volumes of new supply over

GRAPH 1: Investment-grade Office Performance, 1H/2024



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

GRAPH 2: All-grade Office Performance, 1H/2024



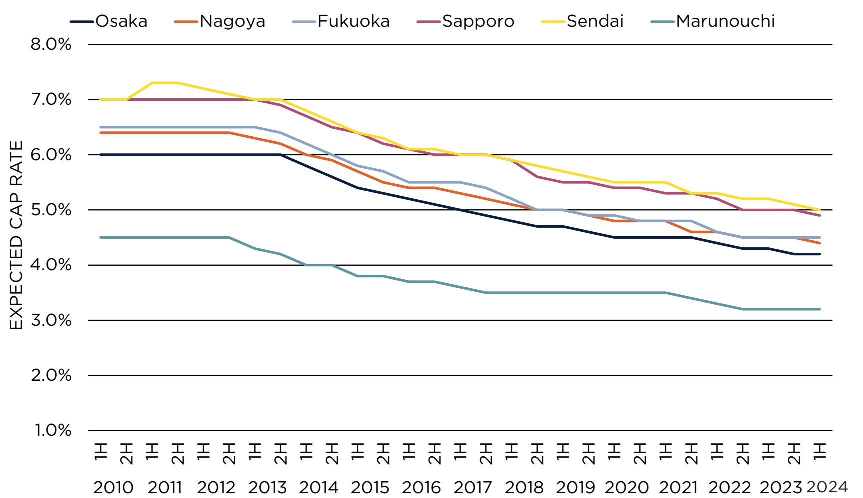
Source Miki Shoji, Savills Research & Consultancy
*Market data as of March 2023 and March 2024.

the year. Considering that some premium new additions over the past year had initially struggled to gain traction, observers may have some concerns regarding temporal instability in respective markets over the year.

This is especially the case in Osaka, which will welcome over 90,000 tsubo of NRA in 2024, the most notable addition being GRAND GREEN OSAKA, which will fundamentally transform the Osaka station area. Elsewhere, several large-scale mixed-use office developments as part of the Tenjin Big Bang scheme look to herald major changes to the Fukuoka office market, while Sapporo will welcome large amounts of new office space in anticipation of the extension of the Hokkaido Shinkansen to Sapporo in the early 2030s. That said, pre-leasing has been sound among many incoming office properties, due to the high demand for modern office space, and there is only some concern.

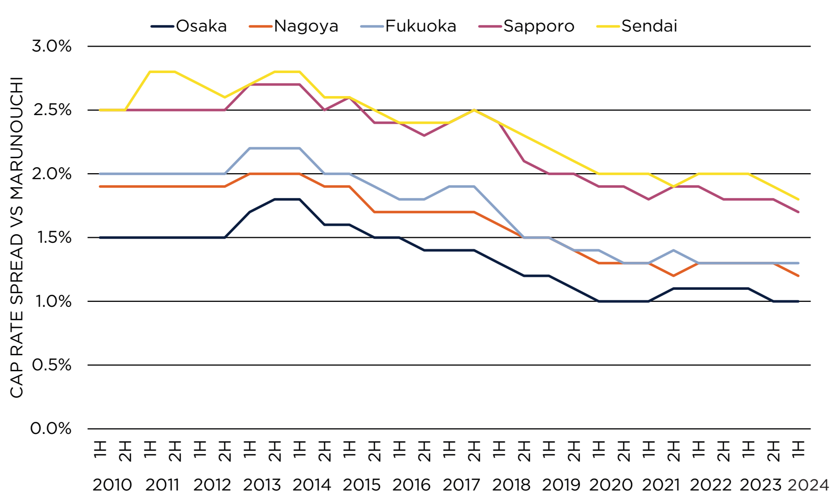
Regional office markets continue to make improvements, largely due to heightened business sentiment, greater levels of office participation, and long overdue office relocations. Though large amounts of supply are in the pipeline for many regional markets, sound demand from tenants should ensure stable absorption and only temporal fluctuations in respective markets.

GRAPH 3: Expected Cap Rates for Grade A Offices, 2010 to 1H/2024



Source Japan Real Estate Institute, Savills Research & Consultancy

GRAPH 4: Expected Cap Rate Spreads (vs Marunouchi), 2010 to 1H/2024



Source Japan Real Estate Institute, Savills Research & Consultancy

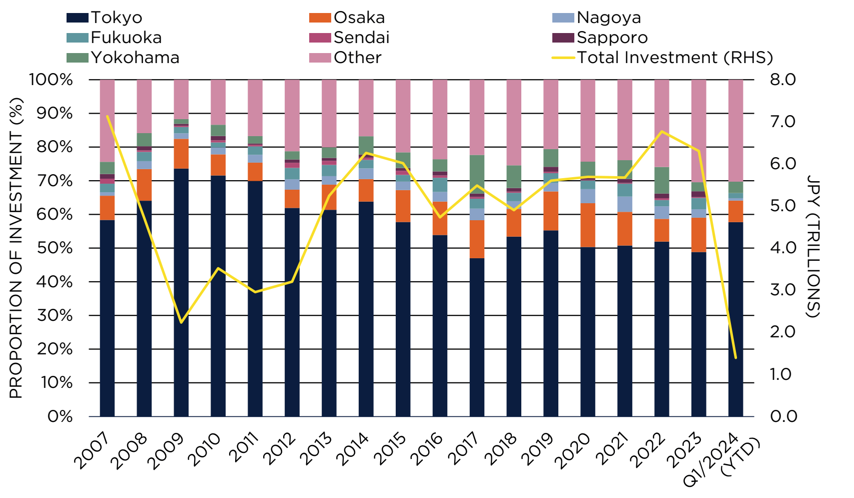
Regional investment-grade office markets have enjoyed moderate improvements over the past half-year. Indeed, Osaka, Nagoya, and Fukuoka all recorded rental growth of 2.3% HoH, 0.9% HoH, and 0.6% HoH, respectively. Meanwhile, investment-grade vacancy in Nagoya tightened considerably by 2.2ppts HoH and by 1.2ppts HoH in Fukuoka, while Osaka vacancy loosened marginally by 0.2ppts HoH. With a handful of significant new developments completed in 2024, some temporary weakness is to be expected, though further improvements in business sentiment and growing rates of office participation should enable further tightening of vacancy rates and sustained rental growth moving forward.

Similarly, the situation has been positive across all-grade office markets over the past half-year. Moderate rental growth was observed among all regional markets, with the largest growth observed in Sapporo at 2.8% HoH. Meanwhile, all-grade vacancy differed across submarkets over the past half-year, tightening slightly in Fukuoka, remaining flat in Nagoya, while some minor weaknesses were observed elsewhere. That said, many instances of loosening were triggered by large new additions in respective submarkets, which should be gradually absorbed over the coming year with the strong business sentiment.

REGIONAL INVESTMENT

According to the bi-annual investor survey conducted by the Japan Real Estate Institute in April 2024, expected cap rates in most regional markets remained either unchanged or on a downward trajectory. In particular,

GRAPH 5: Investment Volumes by Area for All Asset Types, 2007 to Q1/2024 (YTD)



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

expected cap rates tightened in Nagoya, Sapporo, and Sendai. Prices remain elevated across most real estate sectors in Japan, and this compression in expected cap rates is a demonstration of renewed interest in Japanese real estate among investors.

According to transaction data from MSCI, total investment nationwide was almost 10% lower in 2023 compared to 2022. That said, transactions in the office sector have experienced a decline of around 35% over the same period. As of Q1/2024, the volume of office transactions appears to be moderate, though the 2024 figures are preliminary and are expected to increase as more transactions are confirmed.

With business sentiment improving in Japan and the demand for office space among tenants appearing to pick up, renewed interest in the office sector has led to a number of noteworthy transactions over the past half-year in Japan's regional markets. BentallGreenOak acquired the office portion of HOMMACHI GARDEN CITY in Osaka from Sekisui House REIT for JPY44.5 billion, which was the largest such transaction over the past half-year. This may be a harbinger of a return in the appetite for office properties among overseas investors.

Elsewhere, Orix JREIT decided to acquire Sun Mullion Tower in Osaka for JPY19.0 billion, with Blackstone rumoured to be the seller, while an undisclosed buyer acquired the Kawasaki Toshiba Building in Kanagawa from United Urban REIT for the same price.

That said, cross-border investment activity for regional office assets has remained slightly weak in the past half-year. Nevertheless, the office leasing market has bottomed out, and brighter corporate growth prospects, greater levels of office attendance, and the notable yield spread should attract more overseas capital to the sector moving forward.

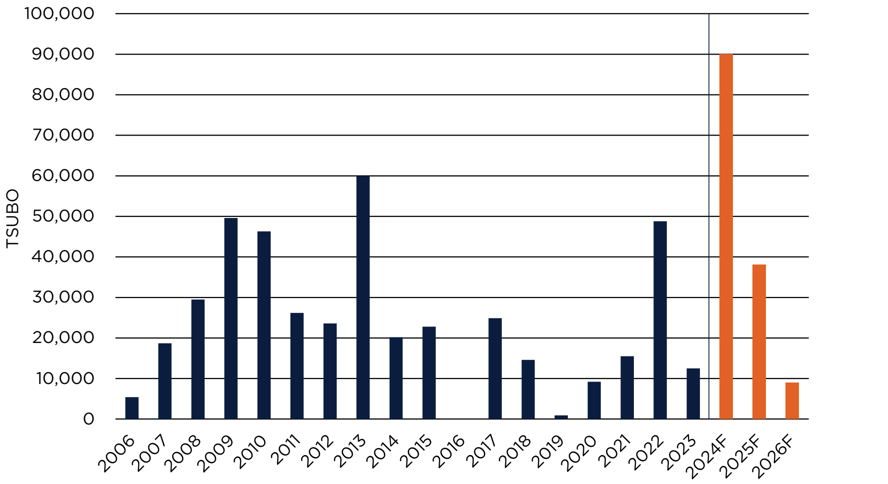
OUTLOOK

Modest rental growth and general improvements in vacancy have been observed across most regional office markets over the past half-year. Indeed, corporate performance has been encouraging, and many companies are taking the opportunity to carry out overdue office relocations and layout changes. Moreover, companies nationwide appear to continue phasing out flexible work arrangements. The labour shortage is also increasingly incentivising companies to provide office layouts with superior amenities that support wellbeing. As such, the strong appetite among tenants for modern office space looks to reinforce this positive situation moving forward.

2024 will see large new office supply introduced to many regional markets, and temporal fluctuations are a distinct possibility. That said, pre-leasing appears to have proceeded uneventfully among many incoming developments, while developers are providing some incentives. Indeed, premium new office space should be welcomed as a sign of confidence in the growth possibilities of respective regional markets. Though secondary vacancies and bifurcation may be observed in areas with weakness, the sound overall appetite for office space should ensure the stable and gradual absorption of existing vacancies.

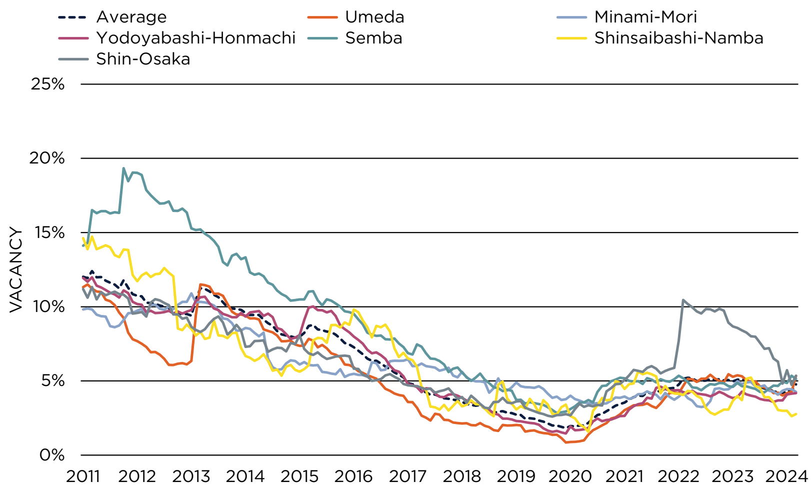
We anticipate that this stable situation should continue throughout 2024. Temporary disruptions are likely to take place due to the completion of large amounts of new supply, but this should not detract from a longer-term growth trajectory, supported by strong business sentiment and demand for long overdue office relocations.

GRAPH 6: New NRA Office Supply in Osaka City, 2006 to 2026F



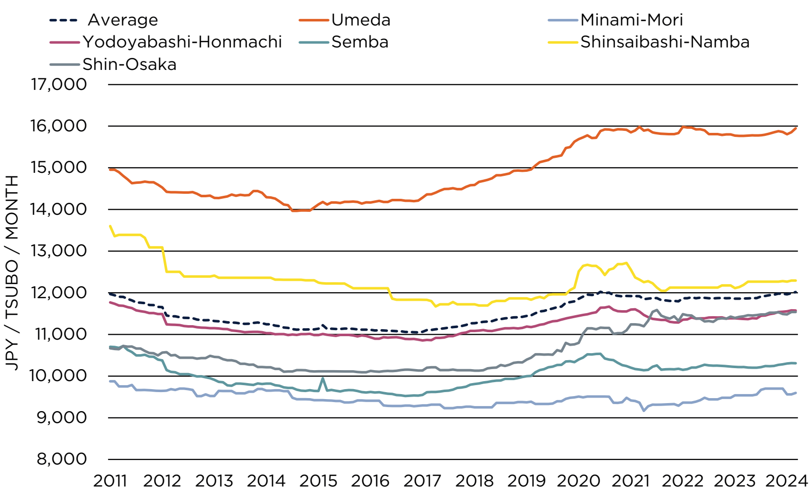
Source Sanko Estate, Savills Research & Consultancy

GRAPH 7: Vacancy Rate in Osaka City by Area, 2011 to Q1/2024



Source Miki Shoji, Savills Research & Consultancy

GRAPH 8: Average Rent in Osaka City by Area, 2011 to Q1/2024



Source Miki Shoji, Savills Research & Consultancy

OSAKA CITY

Net Rentable Area (NRA)

2023 was a relatively quiet year in terms of new office supply in Osaka. As corporate performance and leasing activity continue to improve, the market is witnessing further stabilisation.

That said, observers may have some concerns, due to the new office supply in 2024 of around 90,000 tsubo NRA. The largest addition will be GRAND GREEN OSAKA, delivering nearly 35,000 tsubo of premium NRA to the market. However, the development appears to have experienced sound pre-leasing, with over half of the office space filled already. The developer seems to have provided significant incentives to a main tenant.

Furthermore, the addition of premium, mixed-use office developments should invigorate the market, catering to ever shifting demand from tenants who are seeking more diverse amenities, such as exclusive dining and even sauna space. Indeed, many companies are utilising this period of recovery in the market to carry out long overdue office relocations and layout changes. Overall, while the large uptick in supply is likely to cause some temporal ripples, the absorption of upcoming offices looks to proceed rather smoothly with sound demand.

Vacancy

Investment-grade vacancy rates loosened marginally by 0.2ppts HoH to 4.0% in 1H/2024. Though Osaka welcomed a few new office properties with large amounts of NRA, they experienced strong leasing activity, indicating firm tenant demand for new office spaces. Indeed, vacancy tightened among many submarkets, with the Shin-Osaka submarket tightening by a notable 3.5ppts HoH in particular.

Meanwhile, all-grade office vacancy rates loosened slightly by 0.3ppts HoH to 4.8%. The Shin-Osaka submarket saw the largest tightening of 1.9ppts HoH, while vacancies in the Shinsaibashi-Namba submarket tightened by 1.1ppts HoH to the lowest rate at 2.8%. Similarly, Minami-Mori saw a marginal decline in vacancy, though other submarkets experienced moderate loosening.

Rent

Rents among investment-grade offices strengthened by 2.3% HoH to JPY22,300 per tsubo in 1H/2024. A few premium additions contributed to the increase in the overall rental level, with top rents in Osaka increasing to JPY42,000 per tsubo. That said,

TABLE 1: Osaka Investment-grade Offices

	1H/2024	HOH	YOY
Rent	22,300	2.3%	1.7%
Vacancy	4.0%	0.2ppts	-1.0ppts
Top Rent	42,000	+4,000	+4,000

Source Savills Research & Consultancy

several landlords appear to have carried out rental revisions in order to remain competitive given the influx of modern office space.

All-grade rents increased by 0.6% HoH to JPY12,000 per tsubo. Umeda and Yodoyabashi-Honmachi submarkets experienced the largest improvements of 0.8% HoH. Many other submarkets also experienced rental growth, particularly due to new completions that have above-average rents.

Umeda

Rents for investment-grade offices in the Umeda submarket increased notably by 3.6% HoH to JPY25,700 per tsubo, largely due to the addition of JP Tower Osaka. Meanwhile, investment-grade vacancy loosened marginally by 0.6ppts HoH to 4.7%. Demand for office space in the prime area of Osaka appears to have remained firm overall.

That said, the strength of the Umeda submarket may be tested in the second half of 2024, with the completion of the enormous mixed-use, multi-tower GRAND GREEN OSAKA as well as INOGATE Osaka, both of which should fundamentally transform the area, and are rumoured to have high rents of around mid-to-high JPY30,000 per tsubo. GRAND GREEN OSAKA appears to have already attracted several major tenants, and is well over half pre-leased.

Yodoyabashi-Honmachi

On the other hand, rents for investment-grade offices in the Yodoyabashi-Honmachi submarket decreased by 1.1% HoH to JPY23,300 per tsubo in 1H/2024. Meanwhile, investment-grade vacancy tightened by a marginal 0.1ppts HoH to 3.7%.

In 2024, the market welcomed Midosuji Daibiru, which arrived fully occupied, as well as the Urbannet Midosuji Building, which is largely full. In addition, Osaka Dojimahama Tower appears to have come to the market almost fully leased. Indeed, their strong leasing performance demonstrates the strength of tenant demand for offices.

Shin-Osaka

Investment-grade rents for offices in the Shin-Osaka submarket decreased marginally by 0.4% HoH to JPY18,700 per tsubo. Meanwhile, average investment-grade vacancy rates improved notably for a subsequent period, tightening by 3.5ppts HoH to 2.4%.

The Shin-Osaka submarket recently welcomed Prime Place Shin-Osaka, which introduced over 3,000 tsubo of NRA. The development has been largely leased out, and the overall vacancy rate in the submarket has fallen, highlighting the recovery of demand in the submarket. Furthermore, there will be no completions slated for the near term, which bodes well for the submarket as it continues to make sound improvements.

Outlook

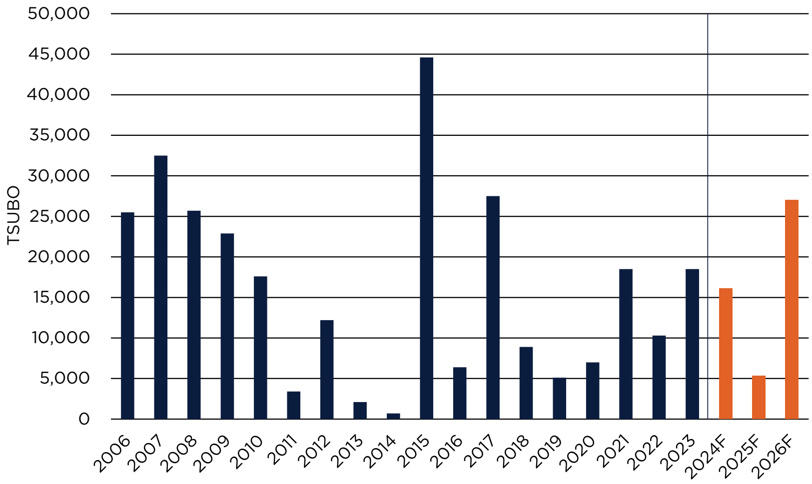
The limited supply introduced to the Osaka office market in 2023 allowed some further breathing room to absorb existing vacant space. That said, fluctuations are likely to occur. This year's supply will be the largest in over three decades in Osaka.

The Umeda submarket, where a majority of this new supply will be concentrated, may be of particular concern. That said, large mixed-use schemes such as GRAND GREEN OSAKA will lead the large-scale improvements of their respective surrounding areas, providing modern and diverse amenities to tenants, and generating new demand in the process.

Looking ahead to 2025, the Osaka market will welcome nearly 40,000 tsubo of NRA, with a large proportion concentrated within close vicinity of convenient Yodoyabashi station. The Yodoyabashi East project appears to be almost half pre-leased, marking an auspicious start.

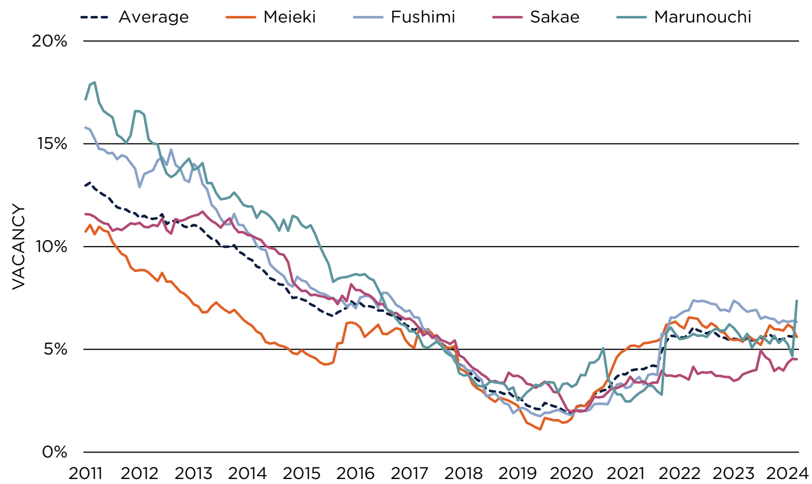
All in all, most office submarkets in Osaka continue to improve, with noticeable progress made in the Shin-Osaka submarket in particular. Indeed, recent strong corporate performance should support office demand moving forward. While temporal fluctuations are likely over the coming year, the longer-term outlook for the Osaka office market appears to be brighter.

GRAPH 9: New NRA Office Supply in Nagoya City, 2006 to 2026F



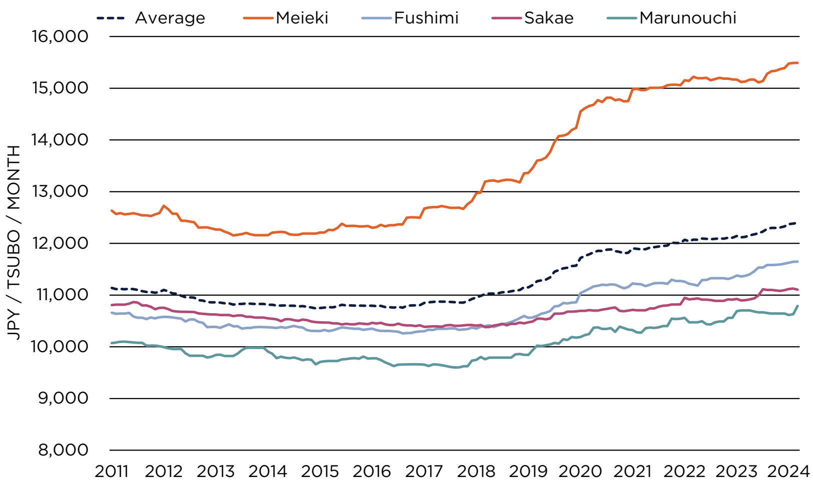
Source Sanko Estate, Savills Research & Consultancy

GRAPH 10: Vacancy Rate in Nagoya City by Area, 2011 to Q1/2024



Source Miki Shoji, Savills Research & Consultancy

GRAPH 11: Average Rent in Nagoya City by Area, 2011 to Q1/2024



Source Miki Shoji, Savills Research & Consultancy

NAGOYA CITY

NRA

The Nagoya office market has welcomed a large volume of new office space in the past half year, and a total of eight major new office completions in 2024 will add over 15,000 tsubo of new NRA to the Nagoya market, with a majority of this supply concentrated in the first half of 2024. Due to recent positive corporate performance, especially growing automobile exports, business confidence appears positive and the appetite for modern office space should hold strong, with decreasing secondary vacancies even among some older properties.

Looking forward, 2025 appears to be a quiet year, and the only new development of moderate scale in the pipeline will be the Nishikidori Kuwana-cho Building, which will reportedly deliver an NRA of around 5,000 tsubo. The limited incoming supply will provide some breathing room for further absorption and stabilisation before a substantial influx of over 25,000 tsubo of NRA in 2026.

Vacancy

Investment-grade office vacancy in Nagoya tightened considerably by 2.2ppts HoH to 5.7% in 1H/2024. The Nagoya Shimizu Fukoku Seimei Building and the 2nd NAGOYA SANCO BUILDING, both completed in the first half of 2024, received strong interest from tenants, and appear to be largely occupied after arriving to the market. In particular, favourable market conditions have spurred increased demand for modern office space, and many companies appear to be carrying out long overdue office relocation and consolidation activity. With new large offices being effectively filled, Hirokoji Cross Tower appears to have also secured some tenants.

All-grade market vacancy remained flat over the past half-year at 5.7% in 1H/2024. Marunouchi's vacancy loosened by 2.1ppts HoH to 7.4%. Despite strong leasing activity observed for the newly completed Nagoya Shimizu Fukoku Seimei Building, its substantial addition of 8,600 tsubo of NRA temporarily contributed to the overall uptick in vacancy in the submarket. On the other hand, Meieki and Fushimi saw vacancies tighten by 0.6ppts HoH and 0.2ppts HoH to 5.6% and 6.3%, respectively.

Rent

In 1H/2024, investment-grade office rents increased by 0.9% HoH to JPY20,600 per tsubo, translating to a yearly increment of 1.9%. This rental growth appears to have

TABLE 2: Nagoya Investment-grade Offices

	1H/2024	HOH	YOY
Rent	20,600	0.9%	1.9%
Vacancy	5.7%	-2.2ppts	-0.8ppts
Top Rent	35,000+	0	0

Source Savills Research & Consultancy

been driven largely by newly completed office developments, which command above-average rents, as well as by the rental increment observed among many office properties. Some new completions initially set lower rents, but strong market demand has led to upward rental revisions in the past half-year.

Meanwhile, all-grade rents strengthened across all submarkets in 1H/2024, increasing by 0.8% HoH to JPY12,400 per tsubo. Marunouchi saw the largest uptick of 1.4% HoH, driven by the premium rents from some newly completed developments. Similarly, rents in the most expensive submarket Meieki, climbed by 1.1% HoH to JPY15,500 per tsubo. Elsewhere, Fushimi and Sakae saw modest rental growth at 0.6% HoH and 0.1% HoH, respectively.

Meieki

Meieki's investment-grade office rents dipped slightly by 0.1% HoH to JPY26,600 per tsubo. Meanwhile, investment-grade vacancy tightened moderately by 1.5ppts HoH to 5.0%.

Despite the notable office addition in the submarket, vacancy rates in Meieki have tightened steadily over the past half-year. The increase in demand appears to have stemmed from tenants expanding their office spaces and companies relocating into the submarket. Furthermore, firm demand was observed in both new completions and existing office buildings, demonstrating the growing popularity for offices in this premier submarket.

Fushimi and Marunouchi

Investment-grade office rents in the Marunouchi submarket increased by 3.0% HoH to JPY 16,700 per tsubo, while rents in Fushimi recorded an uptick of 0.4% HoH to JPY18,500. That said, investment-grade vacancy showed contrasting results, with Fushimi tightening significantly by 5.7ppts HoH to 6.0%, while Marunouchi loosened moderately by 3.1ppts to 9.5%.

The Fushimi submarket will welcome 1,000 tsubo of NRA from the I-FOREST Nagoya Fushimi Building (formerly named Iyo Bank Nagoya Building) in mid-2024. Overall demand for office spaces remains firm in this submarket and vacancy is likely to continue improving.

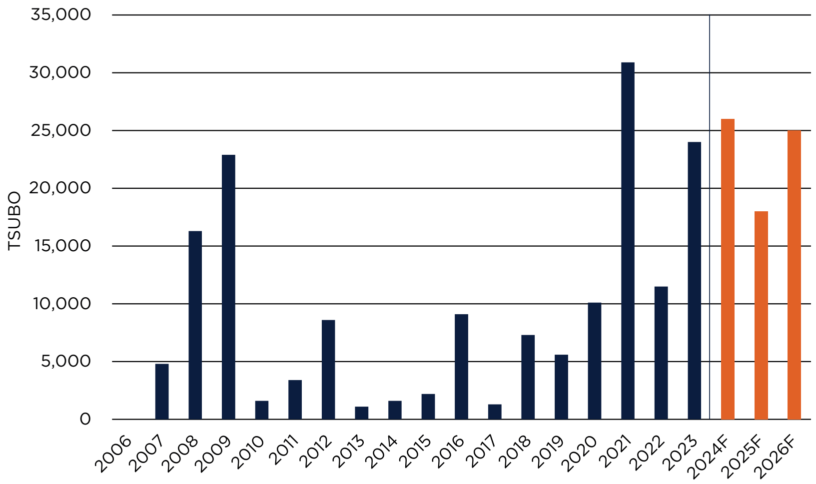
Outlook

Recovery has taken hold and gained pace in the Nagoya office market, with new completions seeing strong demand from tenants. As such, Nagoya's investment-grade rents increased moderately, while investment-grade vacancy tightened over that past half-year.

Demand for office space has been picking up as corporate performance continues to improve in the post-pandemic era, as seen from the recent strong leasing activity. Indeed, companies appear increasingly eager to expand office floor space, comprising a majority of new leasing agreements, and several large relocations have exceeded 1,000 tsubo. In addition, there will be only one prominent addition in the Nagoya office market in 2025, which should provide breathing room for further absorption of existing vacancies and secondary vacancies.

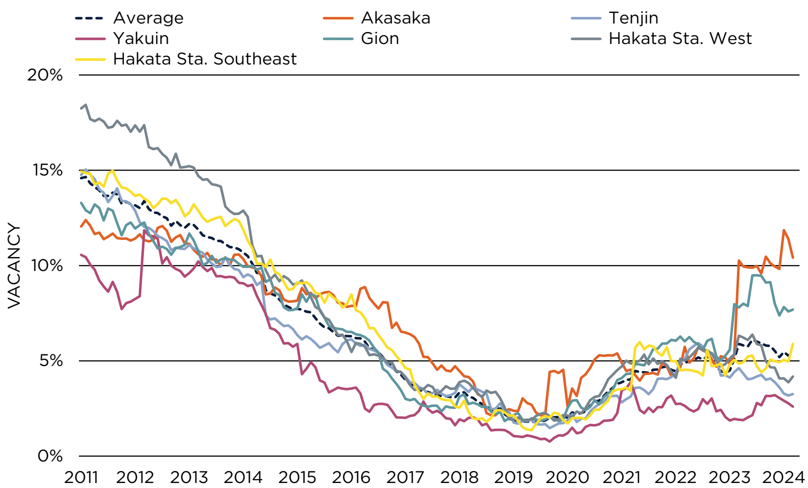
Further down the line, the anticipated addition of two large-scale office projects in Sakae in 2026 will look to further enhance the image of the submarket. Indeed, the recently completed Chunichi Building, which is reportedly nearly fully leased, has infused the submarket with a vibrant atmosphere and has demonstrated the strong pent-up demand for high-quality buildings with top-notch amenities. That said, the large incoming supply may at the same time disrupt the submarket, at least temporarily.

GRAPH 12: New NRA Office Supply in Fukuoka City, 2006 to 2026F



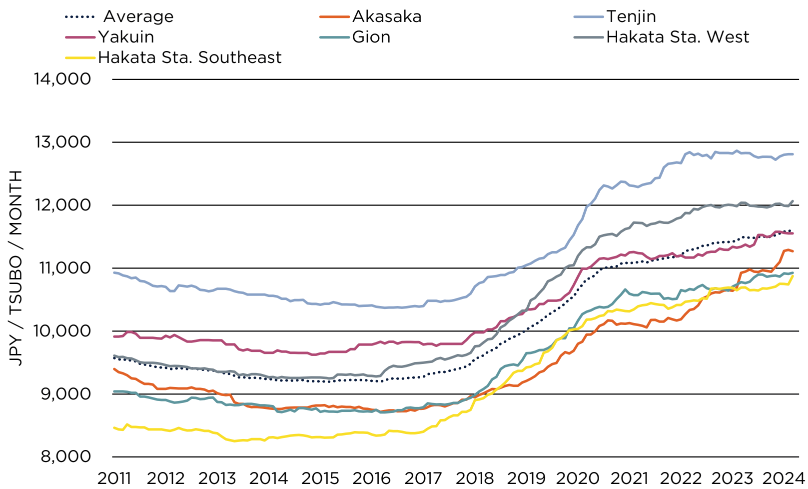
Source Sanko Estate, Savills Research & Consultancy

GRAPH 13: Vacancy Rate in Fukuoka City by Area, 2011 to Q1/2024



Source Miki Shoji, Savills Research & Consultancy

GRAPH 14: Average Rent in Fukuoka City by Area, 2011 to Q1/2024



Source Miki Shoji, Savills Research & Consultancy

FUKUOKA CITY

NRA

Nearly 25,000 tsubo of new office NRA was completed in Fukuoka in 2023, a significantly uptick compared to the previous year. Overall, there has been a sense of optimism in Fukuoka in the post-pandemic setting. The Hakata area is performing particularly well, with strong tenant demand as well as a series of demolitions contributing to notable tightening in the submarket.

New supply in 2024 is set to be similarly large, at over 25,000 tsubo of NRA, concentrated largely in Tenjin and Hakata submarkets. The most notable new addition will be the 14,000 tsubo ONE FUKUOKA BLDG, which will be completed as part of the Tenjin Big Bang project. Despite the likely temporary uptick in vacancy upon its completion in the short term, the transformative effect of these projects should generate new demand and strengthen the Fukuoka office market overall moving forward.

Vacancy

Investment-grade vacancy in Fukuoka has made notable progress, having tightened over the past half-year by 1.2ppts to 3.9%. A number of properties completed over the past year have been largely filled, which is a testament to the sound demand for modern office space in the city. Major incoming developments, such as the ONE FUKUOKA BLDG and the Hulic Fukuoka Building should be the bell weather in the Tenjin submarket.

Meanwhile, the all-grade market saw average vacancy rates fall by 0.4ppts HoH to 5.4%. Most submarkets displayed some moderate improvements over the past half-year, while only the Hakata Station Southeast submarket recorded a moderate loosening in vacancy. In particular, all-grade vacancy tightened in the Tenjin, Yakuin, and Hakata Station West submarkets by 0.9ppts HoH, 0.6ppts HoH, and 0.5ppts HoH, respectively. The situation appears to remain lukewarm in the Akasaka submarket, with all-grade vacancies elevated at 10.1%, the highest in Fukuoka. Fukuoka Daimyo Garden City appears to need some more time.

Rent

In 1H/2024, investment-grade rents in Fukuoka increased notably by 0.6% HoH to JPY19,200 per tsubo. Rental growth was observed in both the Hakata and Tenjin submarkets, largely due to the completion of a number of new properties with above average rents, and with a handful of existing properties with low levels of vacancy raising rents moderately in the growing market.

TABLE 3: Fukuoka Investment-grade Offices

	1H/2024	HOH	YOY
Rent	19,200	0.6%	-0.5%
Vacancy	3.9%	-1.2ppts	-2.2ppts
Top Rent	30,000	0	0

Source Savills Research & Consultancy

Similarly, in the all-grade office market, average rents increased moderately by 1.1% HoH to JPY11,600 per tsubo, which continue to chart a course into record territory. Looking ahead, new offices in the pipeline are forecast to have premium asking rents, which should continue to push average rents up further, while improving the quality of both available office stock as well as the overall landscape of Fukuoka's business districts.

Hakata

Rents of investment-grade buildings in Hakata increased by a moderate 1.3% HoH to JPY20,700 per tsubo. Investment-grade vacancy showed similar signs of improvement, tightening by 0.7ppts HoH to 1.0%. Indeed, vacancy is currently extremely tight due to a combination of strong demand, and a series of demolitions associated with the Hakata Connected project, leading to a sense of scarcity of prime office space.

Though there are several redevelopment projects underway in the submarket, new supply in 2024 is moderate, with the 3,500 tsubo Connect Square Hakata the only major arrival, which appears to be largely full already. Overall, the office market in Hakata is anticipated to be stable over the coming year, and upcoming redevelopment work should gradually improve the landscape of the submarket.

Tenjin

The situation appears positive in Tenjin. Investment-grade rents improved by 0.9% HoH to JPY21,300 per tsubo, while investment-grade vacancy tightened further by 3.9ppts HoH to 7.8%. The Tenjin market appears to have remained stable over the past half-year and appears to be improving, with a handful of large tenant relocations.

A few major office developments are slated for completion in 2024, such as the ONE FUKUOKA BLDG and the Hulic Fukuoka Building. There may be some concerns over the large demand for expensive offices. That said, the wider Tenjin Big Bang improvement project will polish the image of the submarket over the long-term.

Outlook

The Fukuoka office market experienced further growth over the past half-year. Major business districts in Fukuoka witnessed sound demand for new office space, which contributed to some reductions in vacancy, with some rental growth also observed. Indeed, strong net migration during the spring moving season in Fukuoka City, positive business sentiment and the encouraging uptake of new offices indicate that the Fukuoka market is faring well.

New office supply is anticipated to remain elevated over the coming years, with several large-scale developments slated for completion as part of the Tenjin Big Bang and Hakata Connected projects. Despite potential temporal fluctuations, these developments are a sign of confidence in the growth potential of the city. These developments should increase the overall quality of office stock of respective surrounding areas.

Large new expensive office supply in Tenjin slated for completion this year has made some observers worried. Indeed, there may be insufficient tenants who can afford rents around the JPY30,000 level, and this might change the direction of the market.

Nevertheless, bright spots are plentiful for the wider Fukuoka economy, with TSMC's US$20 billion investment into the development of two chip-making facilities in Kumamoto likely to be gamechangers for the wider economy of Kyushu, and will likely stimulate many opportunities in Fukuoka City. Overall, the prospects for the Fukuoka office market appear positive, and major redevelopment plans should fundamentally transform the central submarkets and improve their appeal over the coming years.

SENDAI CITY

Supply and Demand

In 2023, the Sendai market saw an influx of approximately 15,000 tsubo of new office space, the largest since 2011. In contrast, new supply in 2024 will be relatively limited, with a modest addition of around 4,000 tsubo of NRA.

The completion of the Urbannet Sendai-Chuo Building and Woodrise Sendai in November 2023 introduced an aggregate 9,000 tsubo of NRA to the market. Despite experiencing lukewarm demand with high vacancy rates upon completion, they have shown gradual signs of improvement since. On the other hand, T-Plus Sendai and the Sendai KS Building, completed in early 2024 have garnered a more optimistic outlook, effectively drawing demand from tenant relocations and expansions.

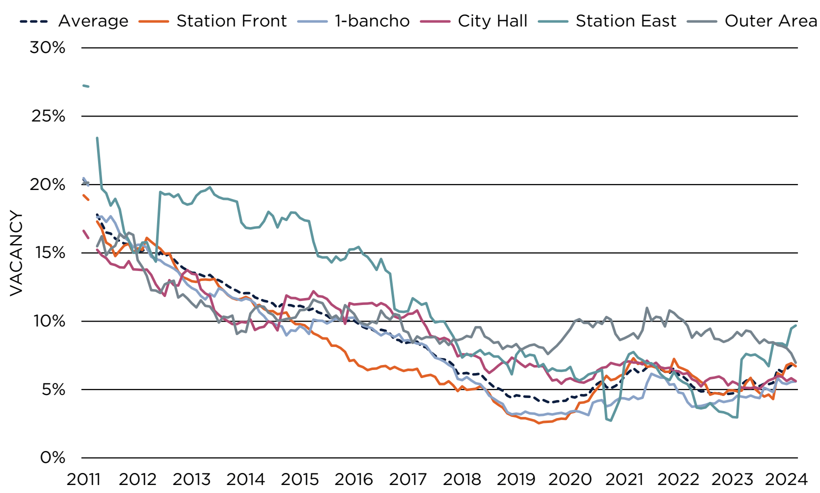
In addition, there are no forecasts for significant new office supply in the latter half of 2024. The limited supply presents a silver lining, providing room for absorption of the remaining vacant space from the previous year. Looking forward, Sendai's Station Front area will welcome another 2,500 tsubo of NRA in 2025.

Vacancy

The all-grade vacancy rate in Sendai increased by 1.3ppts HoH, reaching 6.7% in Q1/2024. Sendai's constituent submarkets showed diverging trends over the past half-year. The Outer Area, known for its affordability, witnessed a significant tightening of 1.5ppts HoH to 7.0%, while City Hall experienced a slight decrease of 0.1ppts HoH to 5.6%.

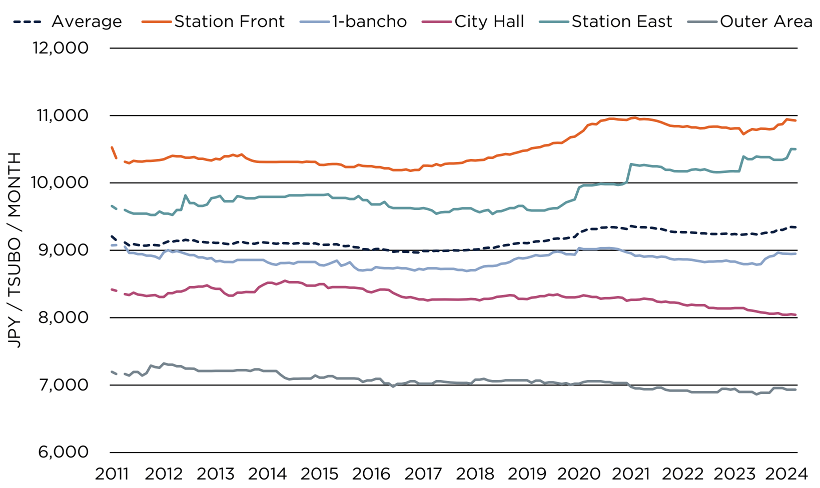
Meanwhile, Station East, 1-bancho, and Station Front submarkets loosened by 3.0ppts, 2.1ppts and 0.6ppts HoH, respectively. The uptick in vacancy can likely be attributed in part to the completion of nearly 15,000 tsubo of new office space over the past half year, as wells as tenants downsizing their office footprints.

GRAPH 15: Vacancy Rate in Sendai City by Area, 2011 to Q1/2024



Source Miki Shoji, Savills Research & Consultancy

GRAPH 16: Average Rent in Sendai City by Area, 2011 to Q1/2024



Source Miki Shoji, Savills Research & Consultancy

Rent

Average all-grade office rents saw a moderate increase of 0.9% HoH to JPY9,350 per tsubo in Sendai. A majority of submarkets experienced rental increments, largely driven by the moderate influx of modern office supply with above average rental levels.

The Station Front submarket experienced the largest increase of 1.2% HoH to JPY10,900 per tsubo due to the completion of the Urbannet Sendai-Chuo Building, which has a relatively high rental level. The Station East, the submarket with the second most expensive average rents also witnessed rental growth at 1.1% HoH to JPY10,500 per tsubo. Indeed, the completion of the Sendai KS Building made a notable contribution to this increment.

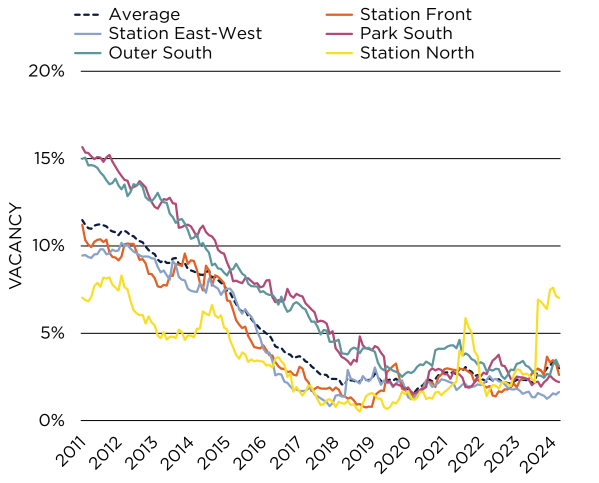
On the other hand, the City Hall submarket experienced a marginal rental contraction of 0.2% HoH to JPY8,050 per tsubo. Looking ahead, rents are expected to stabilise as no new supply is in the pipeline for the remainder of 2024.

Outlook

Sendai has performed reasonably well in 2023, despite the completion of six major office buildings bringing about a sizable influx of 15,000 tsubo of NRA. Average vacancy loosened over the past half year, especially in late 2023 due to the completion of the sizeable Urbannet Sendai-Chuo Building. However, firm demand from firms looking to expand their office footprints has ensured that supply is gradually being absorbed. Moreover, the influx of modern office properties has contributed to a steady improvement in average rents.

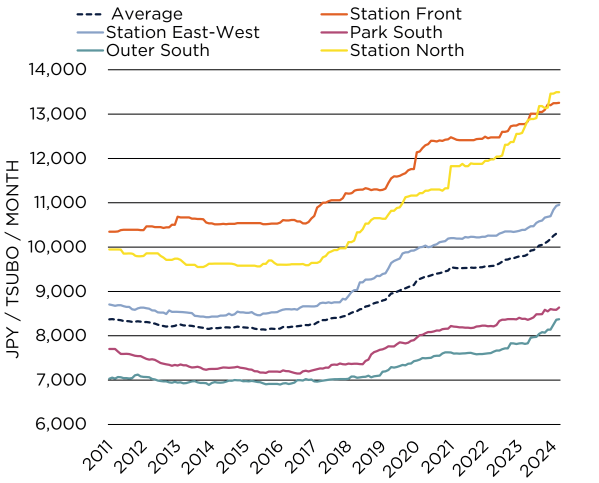
In contrast with 2023, new supply in 2024 is forecast to be modest, which will likely prove serendipitous for the market. Demand from tenants appears to be firm, and with the next new office addition slated for mid-2025, more absorption is likely to take place and vacancy levels should improve overall, leading to greater stability in the market going forward.

GRAPH 17: Vacancy Rate in Sapporo City by Area, 2011 to Q1/2024



Source Miki Shoji, Savills Research & Consultancy

GRAPH 18: Average Rent in Sapporo City by Area, 2011 to Q1/2024



Source Miki Shoji, Savills Research & Consultancy

SAPPORO CITY

Supply and Demand

In 2023, the office market experienced the largest influx of new supply since 2017, with roughly 11,000 tsubo of NRA completed throughout the year. The market appears to have responded positively in large, with tight vacancy rates continuing due to strong demand, particularly from IT and business process outsourcing firms.

In late 2024, Hokkaido Shimbun will occupy nearly 5,000 tsubo of office space in its newly completed headquarters, the Hokkaido Shimbun East 4-Chome Project building located in the Station Front area. Additionally, CONNECT SAPPORO is slated to deliver over 2,500 tsubo of office space in the Park South submarket.

Sapporo will welcome a large amount of new office supply in both 2024 and 2025, each year exceeding 10,000 tsubo. That said, many new offices may give periods of free rent but are unlikely to lower rents, since many landlords are confident of the rental growth trend.

Vacancy

The average all-grade vacancy rate in Sapporo loosened slightly by 0.1ppts HoH to 3.0%. Nevertheless, vacancy levels in Sapporo remain tight. At the submarket level, there were minimal changes. Despite the addition of nearly 2,000 tsubo of new office space from the new Keiwa Odori Building 51, the Station Front submarket experienced a 0.3ppts HoH decrease to 2.6%. This decline was driven by major tenant relocations from nearby submarkets towards more modern offices in the submarket, as well as office expansions in existing premises.

The Station North submarket also welcomed around 1,500 tsubo of new office space from T-Plus Sapporo, and average vacancy in the submarket increased slightly by 0.2ppts HoH to 7.0%. Elsewhere, the Outer South submarket saw the largest increase in vacancy of 0.5 ppts HoH to 3.1%, with a handful of tenants downsizing their office footprints.

Rent

Asking rents in Sapporo remain on an upward trajectory after breaking the JPY10,000 per tsubo level for the first time in 2023, increasing by 2.8% HoH, reaching JPY10,300 per tsubo.

Overall, asking rents increased across all submarkets in Sapporo. The more affordable Outer South submarket experienced the largest rental growth of 3.6% HoH to JPY8,400 per tsubo. New offices also contributed to the overall upward rental trend, with Station North experiencing a notable uptick of 2.4% HoH to JPY13,500 per tsubo and Station Front increasing by 1.6% HoH to JPY13,300 per tsubo.

Outlook

Sapporo's submarkets have enjoyed consistent improvements. The market appears to respond well to new additions despite high asking rents. For instance, the NTT Urban Development's North 1 West 5 project reportedly has asking rents around the mid-JPY20,000 per tsubo level, and over half of the building appears to be pre-leased.

Meanwhile, notable levels of capital have been flowing into the Sapporo office market by both domestic and foreign investors, which are rumoured to be targeting opportunities at a mid-3% to mid-4% cap rate.

Looking ahead, the elevated supply forecast for 2024 and 2025 should drive rental growth further, though vacancy rates should remain tight, owing to strong interest from potential tenants and many developments are projected to be largely filled upon completion.

For more information about this report, please contact us

Savills Japan

Jon Salyards
Managing Director,
Institutional Investment Advisory
+81 3 4330 3266
jsalyards@savills.co.jp

Andy Hurfurt
Managing Director,
Institutional Investment Advisory
+81 3 4330 3328
ahurfurt@savills.co.jp

Savills Research

Tetsuya Kaneko
Managing Director, Head of
Research & Consultancy, Japan
+81 3 4330 3103
tkaneko@savills.co.jp

Simon Smith
Regional Head of Research
& Consultancy, Asia Pacific
+852 2842 4573
ssmith@savills.asia