Japan - December 2021

SPOTLIGHT

Savills Research

Regional Japanese Office Markets

savills

Market fundamentals remain stable amidst slight softening in sentiment

Summary

- Investment-grade offices in most markets have seen further mild corrections, and vacancy rates have also seen moderate increments.
- All-grade office rental growth remains mostly flat, while vacancy has loosened further.
- Expected cap rates for Grade A offices have tightened across most markets, showing the popularity of the sector.
- While the number of workers in Osaka, Aichi, and Fukuoka have been increasing, Miyagi and Hokkaido have begun to see notable declines over the past few years.
- The regional cities in this report all have multiple redevelopment plans in the pipeline that aim to energise and promote the city.
- While the current status of the pandemic appears manageable, uncertainty surrounding new variants is present.

INVESTMENT-GRADE OFFICES[1]

With the pandemic extending into 2021, the regional investment-grade office markets have contracted slightly, with vacancy increasing and rents decreasing in general. However, there are notable disparities between the performances of each region.

Regarding vacancy, all regions have seen rates rise to above 2.0%. Osaka saw the largest loosening of 2.2 percentage points (ppts) YoY, while Fukuoka saw the smallest of 1.4ppts YoY. Much of Osaka's increment stems from the poor performance of new buildings.

Looking at rents, Fukuoka saw growth of 1.4% YoY, and was the only market to see an increase in rents. The rental growth seen in Fukuoka is primarily attributed to the addition of new offices with above-average rents. Meanwhile, Osaka and Nagoya saw moderate rental corrections of 2.6% and 2.4% YoY, respectively. In comparison, Tokyo Grade A offices exhibited a much larger yearly decline of 8.2% in rents, showing that regional cities are performing relatively better.

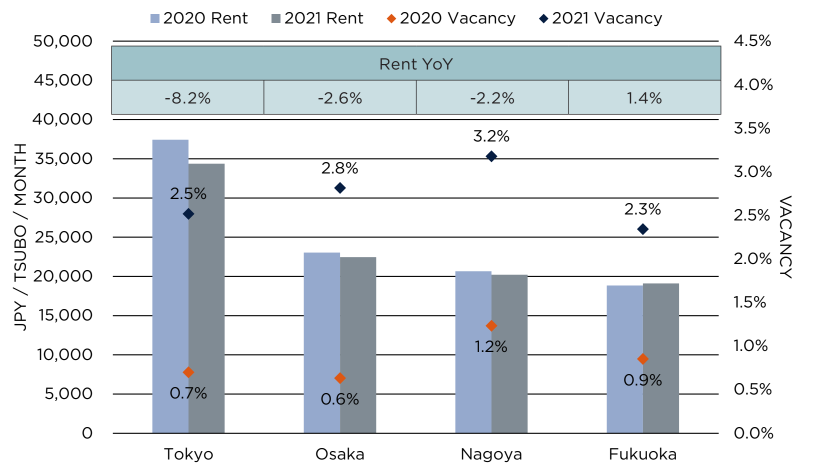
ALL-GRADE OFFICES[2]

With the pandemic dragging into 2021, growth in the all-grade market has slowed for all regional cities. Sapporo and Fukuoka saw

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

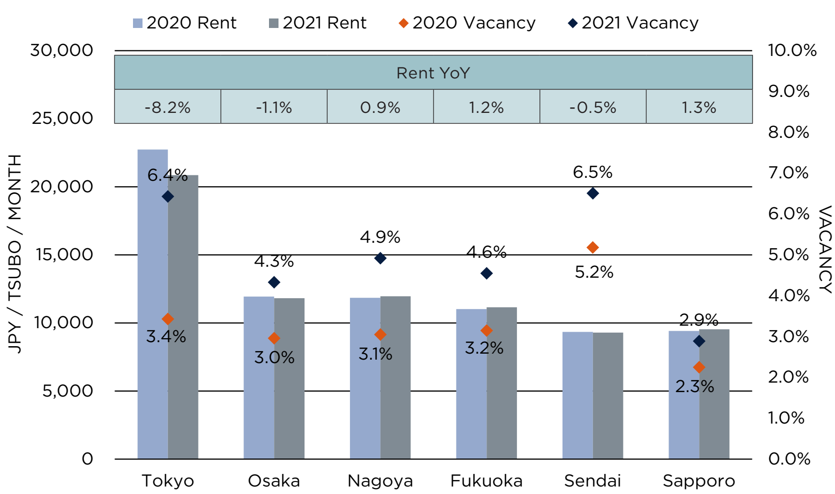
2 "All-grade" refers to offices typically over 1,000 sq m GFA, depending on the market. Data is sourced from Miki Shoji.

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



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

GRAPH 2: All-grade Office Performance, 2H/2021*



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

the largest increments in rents of 1.3% and 1.2% YoY, respectively. On the other hand, Osaka and Sendai saw contractions of 1.1% and 0.5% YoY, respectively. Nonetheless, like investment-grade offices, the overall rental changes of all-grade offices in regional markets have been mild compared to Tokyo, which saw an 8.2% decline YoY.

At the same time, vacancy rates have continued to inch up across all markets. With the exception of Sapporo where vacancy has stayed flattish and below 3.0%, all other markets exhibited vacancies of over 4.0%, having increased between 1.3ppts and 1.8ppts YoY. However, these changes were also smaller than the 3.0ppts loosening seen in Tokyo.

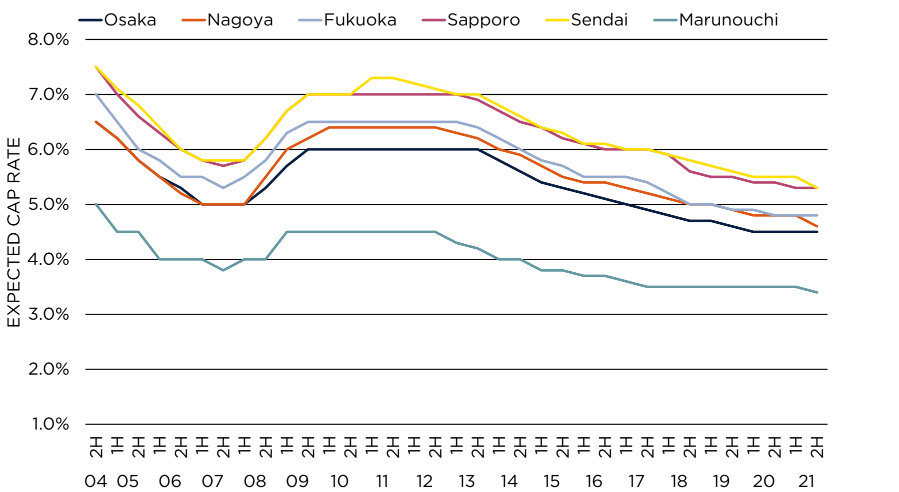
Indeed, regional markets appear to have been comparatively insulated from the pandemic. Tokyo has seen many cases of large floor reductions where multiple thousands of tsubo were returned. In contrast, the scale of floor space being returned rarely exceeds a few hundred tsubo in regional cities. One reason behind the milder changes in regional cities lies in the limited proliferation of remote work.

In comparison, Tokyo has seen notably higher levels of remote work due to the colossal headquarters of many large companies with the infrastructure and capital to implement remote work, as well as a greater proportion of companies in the sectors where remote work is easily feasible, like the IT sector. In addition, workers in Tokyo on average have notably longer commuting times, and companies have a greater incentive to introduce remote work. Indeed, Osaka, which has a relatively higher level of remote work among regional markets, has already started seeing many workers going back to the office.

Another reason for regional markets' stability thus far is their sparing supply compared to Tokyo, which has seen a large amount of supply introduced to the market in the past few years. However, next year might be an inflection point for some regional markets, as a large amount of supply is forecast in 2022. This is especially true for Osaka, which will see the largest new supply since 2013. Nagoya and Fukuoka will also see large new offices like Urbannet Nagoya Nexta and the Fukuoka Daimyo Project.

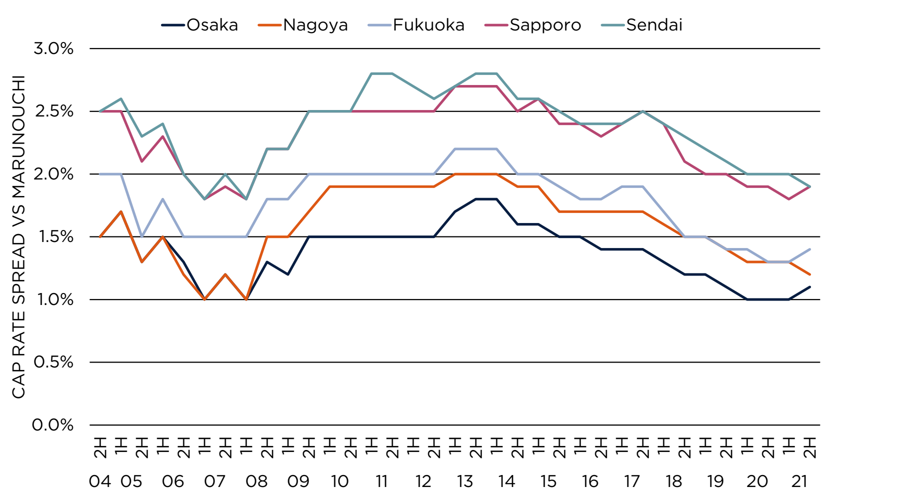
With high vaccination rates and the plummet in COVID-19 cases, the softening sentiment seen in the market over this year seems manageable. Like Tokyo, prime assets remain mostly occupied and have seen few corrections in rent, while buildings with poor access are suffering, resulting in the overall deterioration of market rents and vacancy. However, each region's fundamentals and prospects look different.

GRAPH 3: Expected Cap Rates for Grade A Offices, 2H/2004 to 2H/2021



Source Japan Real Estate Institute, Savills Research & Consultancy

GRAPH 4: Expected Cap Rate Spreads (vs Marunouchi), 2H/2004 to 2H/2021

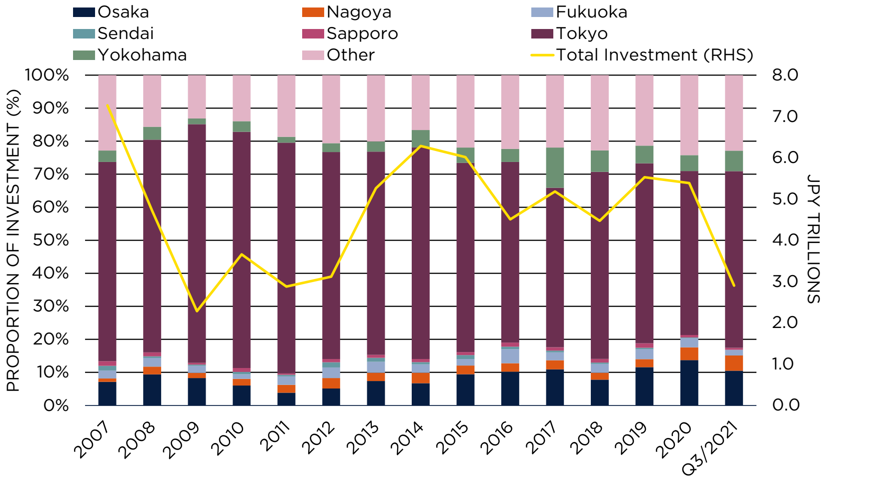


Source Japan Real Estate Institute, Savills Research & Consultancy

REGIONAL INVESTMENT

According to the bi-annual investor survey conducted by the Japan Real Estate Institute (JREI) in October 2021, expected cap rates

GRAPH 5: Investment Volumes by Area for All Asset Types, 2007 to Q3/2021



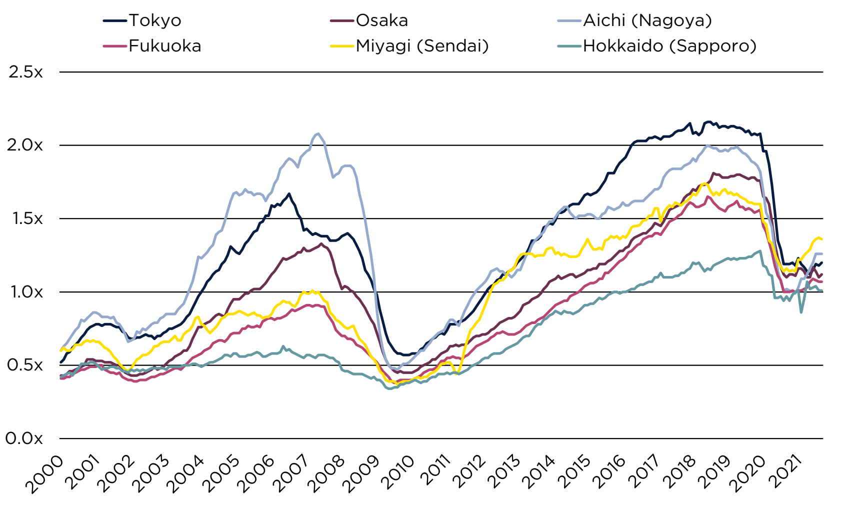
Source RCA, Savills Research & Consultancy
*Transactions where specific locations have not been identified are classified as other.

TABLE 1: BOJ Regional Economic Assessment, October 2021

REGION	TREND	CHANGE VS JUL 2021
Hokkaido (Sapporo)	"The economy has remained in a severe situation due to the impact of COVID-19, and has been more or less flat."	→
Tohoku (Sendai)	"The economy has seen a pause in signs of a pick-up, due mainly to the impact of COVID-19."	↘
Kanto (Tokyo)	"The economy has picked up as a trend, although it has remained in a severe situation, primarily in consumption of services."	→
Tokai (Nagoya)	"The economy has seen a pause in signs of a pick-up."	↘
Kinki (Osaka)	"The economy has been picking up on the whole but downward pressure on consumption has been strong due to the impact of COVID-19."	↘
Kyushu (Fukuoka)	"The economy has seen a slowdown in the pace of its pick-up."	↘

Source Bank of Japan, Savills Research & Consultancy

GRAPH 6: Job-to-applicant Ratios, Selected Prefectures, 2000 to September 2021



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

in Sendai and Nagoya have both tightened 20 basis points (bps), and Osaka's expected cap rates have tightened 10bps from the previous half-year. In comparison, a majority of submarkets in Tokyo also saw cap rates decrease by 10bps. Indeed, the office sector has maintained its popularity even amidst the pandemic, and it may have gained increased attention from investors optimistic about a speedy economic recovery.

Transactions in 2021 have slowed down modestly compared to the previous year. Investment volumes between Q1/2021 and Q3/2021 are 20% lower than the same period in 2020, whilst the office sector saw a similar decline of 21%. It should be noted, however, that figures for 2021 are preliminary, and expected to increase as more transactions are confirmed.

Nevertheless, a large number of big-ticket transactions were observed over the past half-year. For instance, international investor interest also remains high, with Morgan Stanley acquiring 50% of the ownership in the Yokohama Nomura Building for JPY33 billion. Furthermore, while acquisition price was not disclosed, Phoenix Property Investors acquired the Idemitsu Nagahori Building in Osaka. As investors gain a better grasp of the level of demand for offices with the pandemic winding down and most employees returning to the office in regional cities, more transactions are expected in the coming year.

REGIONAL MACRO AND DEMOGRAPHICS

Japan's GDP has not seen significant changes over the past two quarters, shrinking 0.9% in Q3/2021 after growing slightly in Q2/2021. Indeed, COVID-19 cases were high during this period, which drove some uncertainty into the market. This was reflected in the Bank of Japan's (BOJ) Regional Economic Report in October 2021 which had a negative outlook on the economies of most regions, with the exception of Kanto and Hokkaido whose outlooks were neutral. However, with the high vaccination rates and the plummet in COVID-19 cases, prospects of all regions should be able to look forward to recovery as the current pandemic appears manageable.

The job-to-applicant ratio has increased modestly over the past half-year, with all prefectures covered in this report exhibiting levels above 1.0x. Some businesses may have anticipated a recovery and increased hiring.

Demographic changes over the past decade vary significantly across different prefectures. According to estimates of the

Labour Force Survey, Tokyo's growth in its labour force[3] was the largest by far, at 12% over the past ten years. Elsewhere, Osaka, Aichi and Fukuoka saw an increase of about 5 to 6% over the same period. The respective cities of these prefectures serve as major regional hubs and are thus able to attract migrants from surrounding areas with the job opportunities they can provide, and consequently boost demand for offices. Indeed, the office markets in these cities have exhibited resiliency over the past years, which has encouraged developments of new high-quality office buildings. However, Hokkaido saw a decrease of around 4%, and Miyagi's labour force has also been decreasing slowly over the past few years. While Sapporo and Sendai still serve as regional hubs, they appear to be facing stronger demographic headwinds, and may have implications on economic growth in the long-term.

DEVELOPMENTS IN REGIONAL CITIES

Looking ahead, the regional cities in this report all have substantial infrastructural development plans in the pipeline, some of which are covered in the [Japan's Prospects Towards 2030] report. For instance, Osaka's Umekita 2nd Project in the city centre that will introduce new state-of-the-art offices, hotels, commercial space, and residences to the market between 2024 and 2027. Moreover, plans for the country's first integrated resort in Osaka Bay are underway. Since Osaka was a popular destination for overseas tourists before the pandemic, this will provide the city with more opportunities to expand in a post-pandemic world.

In Nagoya, the anticipated Maglev project connecting Tokyo and Osaka will boost its position as a regional hub, and the planned redevelopment projects like Sakae Hiroba and Nagoya Mitsukoshi Sakae should further boost interest in the city. Meanwhile, the Tenjin Big Bang and Hakata Connected projects, which will redevelop a spate of buildings in Fukuoka, will transform the city's landscape and help it progress toward its goal as a technological hub. Tenjin Business Center, the first building as part of the Tenjin Bing Bang, has attained the highest rents in the city at JPY30,000, and attracted large international tenants. After Fukuoka Building's completion in 2024, the top rents in Fukuoka might be almost equivalent to those of Osaka and Nagoya.

Further up north, the Sendai City Reconstruction Project will redevelop many old buildings in order to revitalise the city. In Sapporo, the Hokkaido Shinkansen that will connect Sapporo to the rest of Japan is underway, and there are many development plans around the station. Overall, the redevelopment projects in these cities will strengthen their positions as regional hubs.

OUTLOOK

The regional office market has weakened slightly, with vacancies increasing and rents generally seeing corrections. Indeed, the prolonged state of the pandemic and fluctuating COVID-19 cases over the past half year drove some uncertainty into the market, and many tenants would have continued their wait-and-see stance when deciding on office movements.

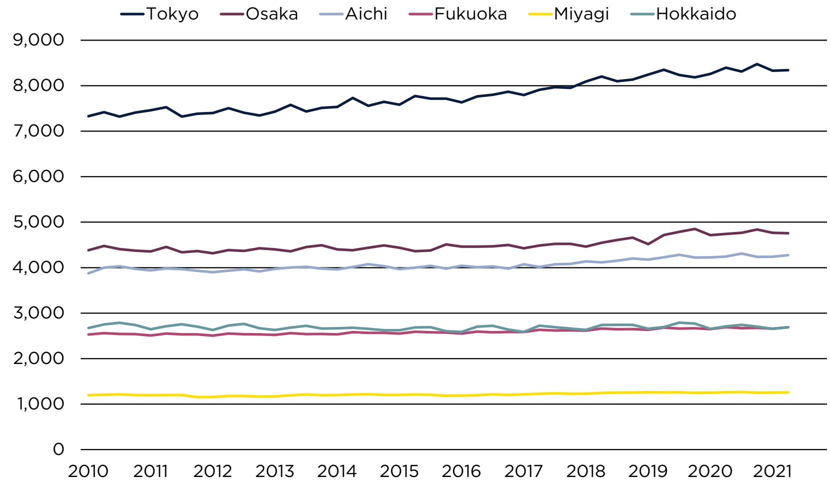
Nonetheless, office fundamentals in Japan appear stable overall. The country's vaccination rate is almost 80% and the number of COVID-19 cases has plummeted. Moreover, according to Google Mobility, countrywide office utilisation is only around 10% lower than pre-pandemic levels, showing that many companies have welcomed employees back to the office.

While remote work has become more popular and has contributed to some increases in vacancy, not many companies have adopted this practice outside of Tokyo. Furthermore, small and medium-sized enterprises (SMEs) are less likely to have the resources and capacity to implement regular remote work, contributing to stable office demand for regional cities.

However, the regional office markets face challenges down the road. For instance, it is uncertain if the market will be able to absorb the large amount of supply forecast to enter the market in the near future, especially in Osaka, given that vacancies have been creeping up. Even if the new offices can fill up space, they might offer substantial incentives. Elsewhere, offices presently with high vacancies are usually poorly located and may further suffer from the introduction of new high-specification offices in central areas. In addition, uncertainty surrounding the pandemic is still present as the potential threat of new virus variants, like the Omicron variant, adds a layer of unpredictability to the market. Overall, while the regional markets' long-term fundamentals remain sound and the current status quo of the pandemic looks manageable, the situation is still fluid and prospects remain unclear.

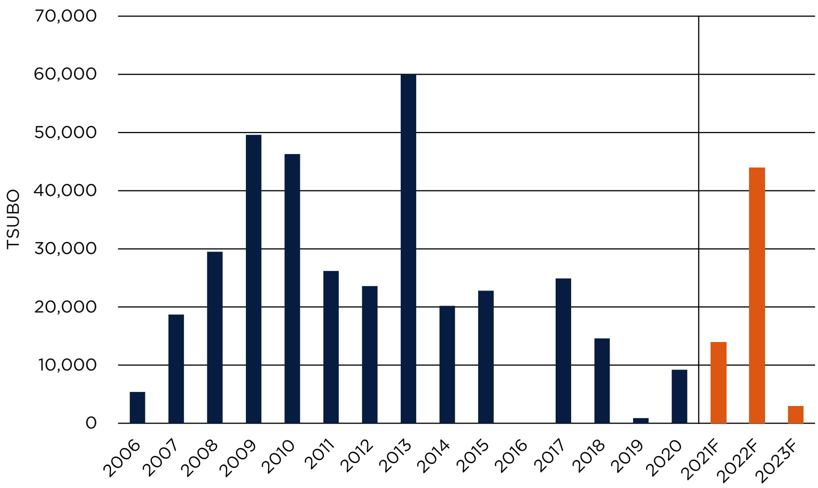
3 Defined as those over 15 years of age who are working or looking for work.

GRAPH 7: Labour Force by Prefecture, 2010 to Q2/2021



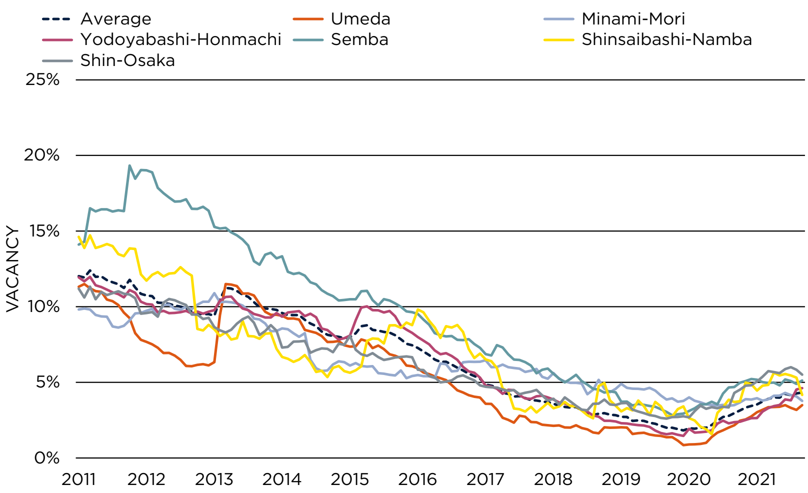
Source Ministry of Health, Labour, and Welfare, Savills Research & Consultancy

GRAPH 8: New NRA Office Supply in Osaka City, 2006 to 2023F



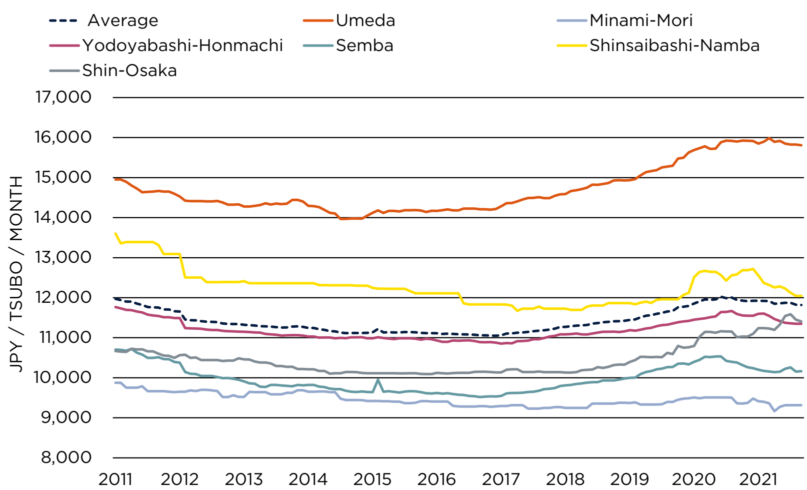
Source Sanko Estate, Building Group, Savills Research & Consultancy

GRAPH 9: Vacancy Rate in Osaka City by Area, 2011 to Q3/2021



Source Miki Shoji, Savills Research & Consultancy

GRAPH 10: Average Rent in Osaka City by Area, 2011 to Q3/2021



Source Miki Shoji, Savills Research & Consultancy

OSAKA CITY

Net Rentable Area (NRA)

In 2022, the market looks to add over 40,000 tsubo of NRA, four times larger than 2021's supply and the largest amount since 2013. Despite the relatively poor reception of new offices completed in 2021, two of the largest buildings that make up most of 2022's supply, Osaka Umeda Twin Towers South with over 25,000 tsubo of NRA and the Nippon Life Yodoyabashi Building with over 10,000 tsubo of NRA, have seen modest amounts of pre-leasing activity. Furthermore, minimal supply is expected in 2023, which should give the market additional time to absorb the new supply.

However, 2024 looks to add over 60,000 tsubo of NRA to the market – around 50% more than the levels in 2022. The two most notable additions will be the second phase of the Umekita Project and the Umeda 3-Chome Project. One concern is that this new supply will be concentrated around the Umeda area, which already will see a large influx in 2022. The submarket might not be ready to absorb the sizable amount of supply in such a short time frame, although it admittedly has three years till then to prepare.

Vacancy

Investment-grade vacancy rates have increased 1.5ppts HoH to 2.8%. A sizable portion of this increase came from the relatively large building that opened in August 2021, the Honmachi Sankei Building with 5,700 tsubo of NRA, which remains largely vacant.

All-grade vacancy rates continued their slow upward ascent this half-year to the highest levels seen since 2017. Indeed, vacancy rates have climbed 2.3ppts since the start of 2020 and 1.1ppts YoY to 4.3%. Some smaller new buildings in areas such as Yodoyabashi-Honmachi and Shin-Osaka still sit more than half empty and have contributed to the vacancy uptick.

Rent

Rents for investment-grade offices in Osaka have decreased 1.1% HoH to JPY22,500. Although the pre-pandemic momentum carried average rents to over JPY23,000, rents have now contracted back to 2019 levels. Specifically, outside Semba which stayed flat at JPY17,500 per tsubo, all other submarkets have seen a decline.

All-grade rents have also dipped slightly over the past half-year and are currently at levels that were seen right before the pandemic. Specifically, rents in Osaka saw a dip of 1.1% YoY to JPY11,800 per tsubo. At the submarket level, Shinsaibashi saw the largest

TABLE 2: Osaka Prefecture Key Macro Indicators

	TOKYO	OSAKA
Real GDP (JPY trillion) (FY2018)	105.9	39.0
Real GDP (YoY%)	0.5%	0.1%
% of Japan (FY2018)	19%	7%
Population (million)	14.0	8.8
Job to applicant ratio	1.2	1.1

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

TABLE 3: Osaka Investment-grade Offices

	2H/2021	HOH	YOY
Rent	22,500	-1.1%	-2.6%
Vacancy	2.8%	+1.5ppts	+2.2ppts
Top Rent	35,000	0	0

Source Savills Research & Consultancy

decline of 4.3% YoY to JPY12,000 per tsubo, and other submarkets saw declines ranging 0.5% to 2.1%. The only member to buck this trend was Shin-Osaka, which saw an increase of 3.6% YoY to JPY11,400 per tsubo due to the PMO EX Shin-Osaka building's asking rents bringing up the overall submarket average.

Despite the contraction seen over the past year, rental levels are currently overall higher than they were two years ago. Prime assets have maintained stable performances while top rents hover at JPY35,000 per tsubo. Furthermore, Umeda Twin Towers South, which will open in Spring 2022, could reach upwards of JPY38,000 per tsubo, setting a new top rent. In addition, the Umeda 3-Chome project, slated for completion in 2024, is expected to push the ceiling even higher.

Umeda

Umeda's investment-grade rents contracted by 5.6% HoH to JPY25,100, which has caused its premium over the rest of the submarkets to decrease from 17% to 12% over the last half year, though it remains the most expensive submarket in Osaka. The range of investment-grade rents is still between JPY20,000 and JPY35,000 per tsubo, having remained largely unchanged through the pandemic. While some patches of vacant space have arisen in a few buildings, vacancy levels are still tight at 2.0%.

Yodoyabashi-Honmachi

The investment-grade offices in the Yodoyabashi-Honmachi submarket have overall managed a slight increase in rent by 1.3% HoH to JPY23,400. However, in terms of vacancy, the submarket saw an loosening of 8.0ppts HoH to 8.4%.

The vacancy loosening, and to a lesser extent the increase in rents, were largely due to the addition of the Honmachi Sankei Building, which remains mostly unoccupied and has above average rents. With other new offices coming onto the market in nearby locations in 2022, further rental adjustments might be necessary in order to quickly attract tenants.

Shin-Osaka

Shin-Osaka's investment-grade rents softened by 1.1% HoH to JPY20,400 per tsubo. It appears that many buildings in Shin-Osaka are also struggling to fill floors with rents around JPY20,000 per tsubo, much lower than pre-pandemic levels of JPY25,000. In addition, buildings further away from the station have also experienced some upticks in vacancy.

A spate of medium-sized completions is expected in Shin-Osaka over the next year. For instance, the Shin-Osaka Dai 2 NK and Dai 3 NK Buildings and Shin-Osaka Dai 5 Doi Building will add over 10,000 tsubo of NRA to the submarket. This new supply is likely to further dampen the submarket that is already struggling.

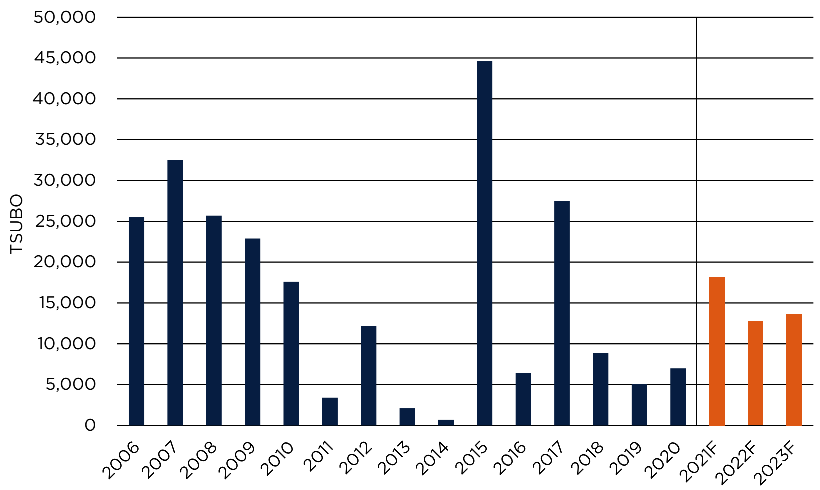
Outlook

Since the middle of last year, the market has continued to deteriorate, with rents falling and vacancy creeping up. Leasing activity is rather stagnant, and large spaces that are more than 200 tsubo are currently difficult to find tenants. New leases with rents in the JPY30,000 range are becoming unheard of in the current environment.

Given these situations above, landlords have continued to adjust rents in search for an equilibrium point with tenants. Many landlords also have to offer various incentives to keep tenants, and some have compromised by allowing tenants to partially return their rented space, a practice that is uncommon outside Tokyo and Osaka. Potential vacancy, which could materialise next spring, is a big concern for landlords.

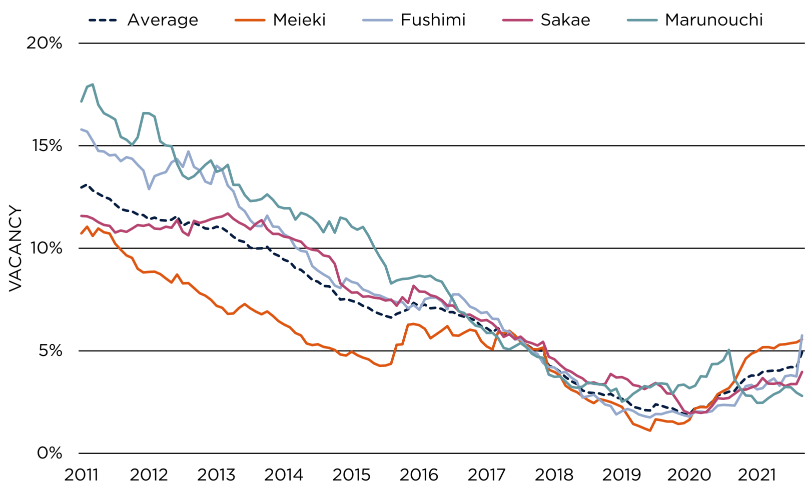
Looking ahead, some of supply in 2022 appears pre-leased, which is an encouraging sign for the market. Additionally, although some major companies in Osaka implemented remote work, many workers seem to have started to return to the office with the pandemic subsiding. After the large supply in 2022, the market will have some breathing room in 2023 as supply is limited that year. Therefore, how the market performs in 2022 will be an important indication for Osaka's mid-term prospects.

GRAPH 11: New NRA Office Supply in Nagoya City, 2006 to 2023F



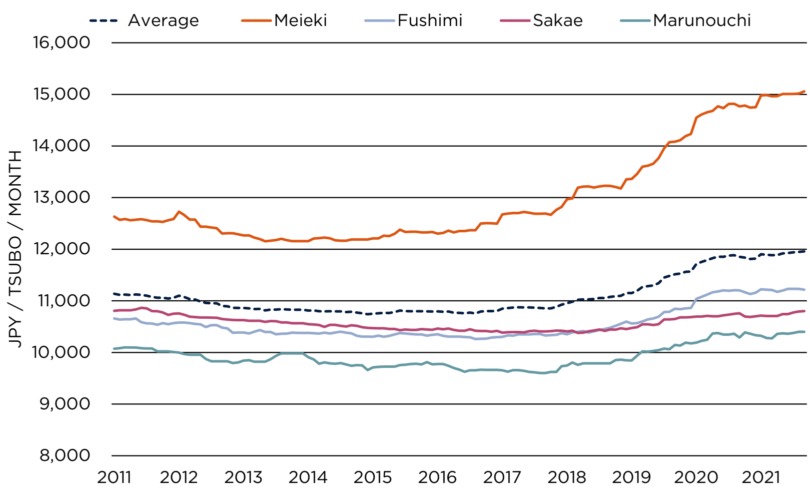
Source Sanko Estate, Savills Research & Consultancy

GRAPH 12: Vacancy Rate in Nagoya City by Area, 2011 to Q3/2021



Source Miki Shoji, Savills Research & Consultancy

GRAPH 13: Average Rent in Nagoya City by Area, 2011 to Q3/2021



Source Miki Shoji, Savills Research & Consultancy

NAGOYA CITY

NRA

Although total NRA is still below the peak it reached in 2017, it increased steadily throughout 2021, adding a little over 18,000 tsubo of NRA throughout the year. The biggest contributors to NRA in 2021 were the Nagoya Mitsui Building North and BIZrium Nagoya, which together comprise more than half of the supply in 2021.

Overall, market reactions have been mixed. Nagoya Mitsui Building North, which opened in February with 4,500 tsubo of NRA, has seen its occupancy continue to increase. Elsewhere, BIZrium Nagoya, which opened in October with 6,500 tsubo of NRA, still has some vacant space, but there is hope that it will fill up soon given its unique selling points and the impressive footfall that goes through the retail space of the property. On the other hand, other new buildings that will be completed later in the year have not fared as well in their pre-leasing activities. Nonetheless, landlords appear confident in their ability to attract new tenants if they lower rents.

Looking ahead, 2022 and 2023 will provide lower levels of supply than 2021. The largest building to open in 2022, Urban Net Nagoya Nexta, with nearly 5,000 tsubo of NRA, is nearly fully pre-leased. In fact, it attracted large tenants such as NGK who took a 1,400 tsubo lease after citing the building's convenience and amenities. Overall, the area and infrastructure redevelopments in Nagoya will continue increasing the liveability and vibrancy of the city and should help to continue to attract tenants.

Vacancy

For the first time since 2017, the vacancy rate for investment-grade buildings exceeded 3%, increasing 0.5ppts HoH and 1.9ppts YoY to 3.2% in 2H/2021. The primary cause was the relatively poor performance of a few buildings in inconvenient areas within Sakae and Marunouchi. On the other hand, while all other submarkets saw increases, Meieki's vacancy stayed flat HoH at 3.1%. All things considered, investment-grade buildings in Nagoya appear to be holding well.

Elsewhere, the all-grade market's vacancy stands at 4.9%, increasing 1.9ppts YoY. Fushimi and Meieki led the increases with a loosening of 3.4ppts YoY to 5.8% and 2.0ppts to 5.6%. However, it is worth noting that Fushimi and Meieki saw a large amount of new supply in 2021. Sakae also contributed to vacancy increase by loosening by 1.1ppts YoY to 4.0%. On the other hand, Marunouchi bucked the trend and saw a decrease of 0.8ppts YoY to 2.8%. That said, Marunouchi's vacancy is likely to see a jump as the Marunouchi One will be opening late this year with a large amount of vacant space.

TABLE 4: Aichi Prefecture Key Macro Indicators

	TOKYO	AICHI
Real GDP (JPY trillion) (FY2018)	105.9	39.4
Real GDP (YoY%)	0.5%	1.9%
% of Japan (FY2018)	19%	7%
Population (million)	14.0	7.5
Job to applicant ratio	1.2	1.3

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

TABLE 5: Nagoya Investment-grade Offices

	2H/2021	HOH	YOY
Rent	20,200	-1.7%	-2.2%
Vacancy	3.2%	+0.5ppts	+1.9ppts
Top Rent	35,000	0	0

Source Savills Research & Consultancy

Rent

Investment-grade rents declined 1.7% HoH and 2.2% YoY to JPY20,200 per tsubo. This stemmed from many older buildings with poor accessibility in Meieki and Marunouchi experiencing seeing rental corrections. Newer buildings that are set to open this winter are also expected to open with rents below the market average of investment-grade buildings, suggesting the market average will probably continue to decrease.

In contrast, all-grade rents have continued to slowly rise by 0.9% YoY to JPY12,000 despite the pandemic slowing down the rate of growth. The growth was led by the submarkets of Meieki and Marunouchi, which grew 2.0% and 1.1% YoY, respectively.

Meieki

Meieki's investment-grade rents saw a decrease of 2.8% HoH and 5.4% YoY to JPY27,000, but still remain the highest in Nagoya. It appears that the rental adjustments helped secure tenants in this submarket as its vacancy has managed to stay flat HoH at 3.1% while the other submarkets saw a loosening.

With the aforementioned rental corrections, the range of rents has decreased to between JPY23,000 and JPY35,000, showing a decrease of JPY3,000 on the lower end. Like other markets, buildings without convenient access to train stations are disproportionally suffering, and consequentially lowering the rents of the overall market.

Fushimi and Marunouchi

Investment-grade rents in Fushimi and Marunouchi saw diverging trends in 2H/2021. The former stayed flat HoH and YoY at JPY18,800 per tsubo while the latter saw a contraction of 2.2% both HoH and YoY to JPY16,800 per tsubo.

The changes in vacancy reflected a similar trend, with Fushimi seeing a minor loosening of 0.6ppts HoH to 1.3%. This suggests that the market may have found an equilibrium point for rents. However, the Kanden Fudosan Fushimi Building opening in November may disturb this balance. In contrast, Marunouchi has seen vacancy loosen 1.4ppts HoH and 0.9ppts YoY to 2.1%. Like Fushimi, Marunouchi also has a major building opening this winter that will likely increase the average vacancy of the whole submarket.

Outlook

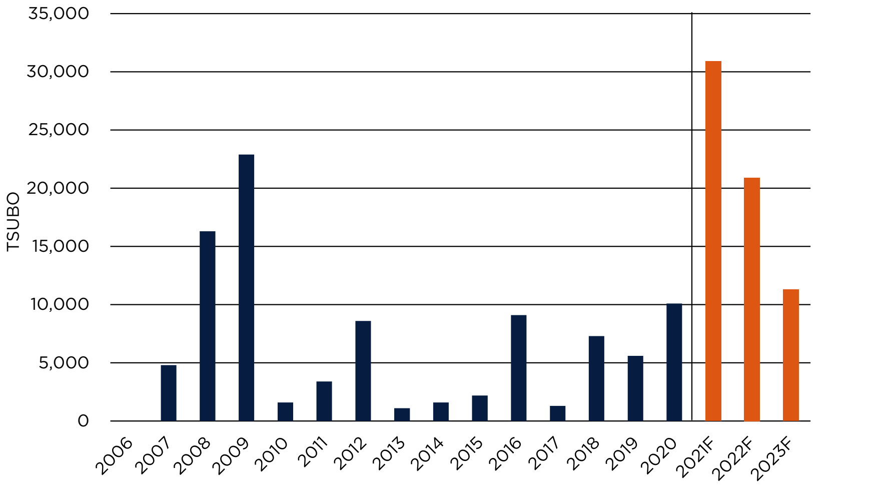
The Nagoya office market appears tepid with the investment-grade market showing some weakening. Although some newer buildings are struggling, offices with asking rates that are perceived as reasonable appear able to secure tenants without much difficulty.

The new BIZrium Nagoya is gaining traction. The property was reportedly 70% occupied at its opening. The project is unique in its concept as its office floors are located on top of a shopping mall, and also because the property is stretched horizontally.

Currently, some buildings in Nagoya have vacancies of over 2,000 tsubo, especially in new buildings supplied this year. In addition, Hirokoji Cross Tower has large amount of availability which is increasing vacancy overall in Nagoya. That said, those buildings should become filled as landlords start to adjust their target rents to where the market is trending.

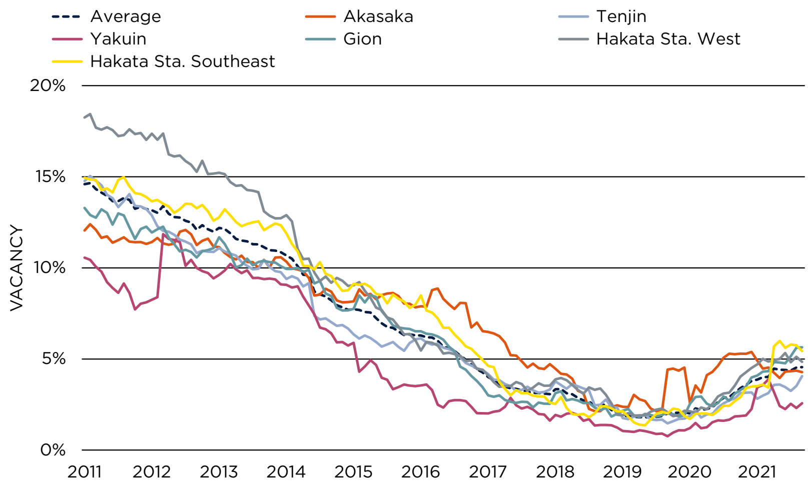
Fortunately, confidence levels in Nagoya's biggest sector, manufacturing, have been growing over 2H/2021. For instance, the largest manufacturer, Toyota, may resume expansion plans as its profits soar. This will likely have a knock-on effect to its affiliates and vendors, and potentially fuel office leasing demand moving forward in Nagoya. Together with the redevelopments downtown that have continued to the vibrancy and liveability of the city, Nagoya's outlook appears stable.

GRAPH 14: New NRA Office Supply in Fukuoka City, 2006 to 2023F



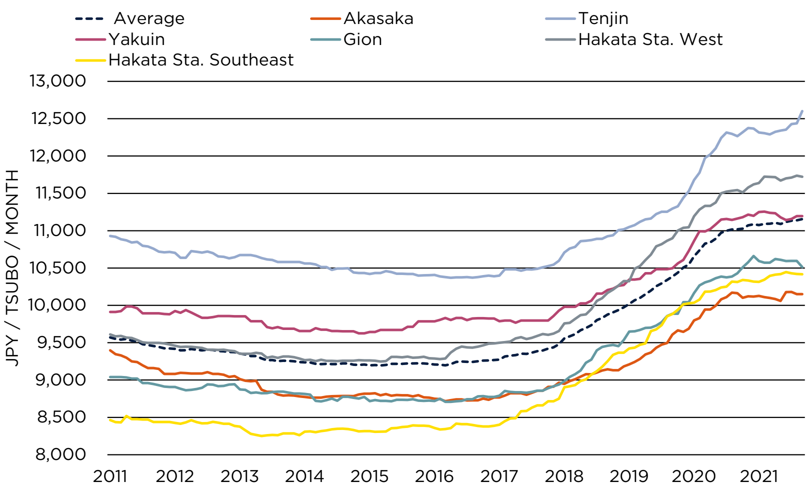
Source Sanko Estate,Savills Research & Consultancy

GRAPH 15: Vacancy Rate in Fukuoka City by Area, 2011 to Q3/2021



Source Miki Shoji, Savills Research & Consultancy

GRAPH 16: Average Rent in Fukuoka City by Area, 2011 to Q3/2021



Source Miki Shoji, Savills Research & Consultancy

FUKUOKA CITY

NRA

In 2021, Fukuoka introduced the largest supply in the past decade, and the office stock of the market is at its peak. Most of the increase was seen in the main two areas of Fukuoka - Tenjin and Hakata. Going forward, supply is expected to continue increasing in 2022 before cooling off slightly in 2023.

Overall, the market reaction to the new supply in 2021 has been positive, with most of it having been absorbed. Impressively, Tenjin Business Center, the first building utilising the deregulation that came with Fukuoka City's redevelopment scheme, Tenjin Big Bang, came online nearly fully occupied, showing the strength of the market. 2022 will also introduce over 20,000 tsubo of NRA, approximately four times the average amount introduced between 2011 and 2020. While most of the supply in 2022 will be built a little further away from stations, these properties appear to be successful in attracting tenants so far. One exception would be the Fukuoka Daimyo Project, which will open at the very end of 2022 and therefore still has some more time for pre-leasing.

After a slight reprieve in 2023, various redevelopments are expected to come to the market in 2024. For instance, 2024 will see Nishitetsu's redevelopment of the Fukuoka Building and is reportedly aiming for rents of JPY35,000 per tsubo – near top rents in Osaka and Nagoya. Moving forward, more buildings are expected to apply for redevelopment to utilise the height and floor area ratio deregulations. Overall, Fukuoka looks set to refresh its office stock, which will be a necessary move given that it has one of the oldest amongst Japan's regional cities.

Vacancy

After exceeding 1% for the first time in five years, vacancy levels of investment-grade buildings continued to rise by 0.9ppts HoH to 2.3%. The root cause for the increase was the secondary vacancy caused by new supply, and some residual vacancy in the new buildings. However, vacancy levels appear manageable at present.

At the submarket level, Tenjin saw the largest increase in vacancy of 3.4ppts HoH to 5.1%. The addition of the enormous Tenjin Business Center contributed to most of this temporary increase, as it did not come to the market fully leased. On the other hand, vacancy increments in other submarkets were minor, and submarkets like Yakuin and Nakasu actually saw contractions in vacancy.

Elsewhere, the all-grade market saw a loosening of 1.4ppts YoY to 4.6%. Here, Southeast of Hakata Station and Gion were the primary contributors, with increments

TABLE 6: Fukuoka Prefecture Key Macro Indicators*

	TOKYO	FUKUOKA
Real GDP (JPY trillion) (FY2018)	105.9	19.1
Real GDP (YoY%)	0.5%	0.9%
% of Japan (FY2018)	19%	3%
Population (million)	14.0	5.1
Job to applicant ratio	1.2	1.1

Source Cabinet Office, Fukuoka Prefectural Government, Savills Research & Consultancy
*Real GDP for Japan is as of Q3/2020 and is preliminary, for Tokyo, Fukuoka and % of Japan, 2015.

TABLE 7: Fukuoka Investment-grade Offices

	2H/2021	HOH	YOY
Rent	19,100	0.7%	1.4%
Vacancy	2.3%	+0.9ppts	+1.5ppts
Top Rent	30,000	+5,000	+5,000

Source Savills Research & Consultancy

of 2.7ppts YoY to 5.4% and 2.6ppts YoY to 5.6%, respectively. Meanwhile, Akasaka saw its vacancy contract over the last year by 1.0ppts to 4.3%. Overall, small to mid-sized buildings still generally have higher vacancies compared to their larger counterparts.

Rent

In 2H/2021, investment-grade rents in Fukuoka increased by 0.7% HoH and 1.4% YoY to JPY19,100 per tsubo, partially stemming from the new addition of Tenjin Business Center at JPY30,000 per tsubo. Throughout the pandemic, Fukuoka rental levels have maintained steady growth thanks to a plethora of new buildings, and steady demand supplied by various companies opening regional offices in Fukuoka.

All-grade rents in Fukuoka have maintained growth and increased to JPY11,200 per tsubo in 2H/2021 – once again setting a new high. This translates to an increase of 1.2% YoY, higher growth than most of its regional peers.

Hakata

Investment-grade buildings in the Hakata submarket have remained popular, but rents have seen a slight contraction by 0.3% HoH to JPY20,400 per tsubo. Despite the contraction over the past half year, Hakata has still maintained an annual growth of 0.6%. Overall, rents still range between JPY17,000 and JPY25,000.

Hakata saw a moderate loosening in vacancy of 0.4ppts HoH to 1.8%. The most recent building to open in Hakata, Hakata Fukami Park Building, continues to see progress in acquiring new tenants, suggesting that vacancy may decrease moving forward.

Tenjin

Rents of Tenjin's investment-grade buildings saw an increase of 3.5% HoH to JPY21,400. As mentioned earlier, the primary source of growth was the addition of Tenjin Business Center. The building was also able to attract some large international names such as Google and the Boston Consulting Group. In addition, Japanet has also reportedly moved its Tokyo headquarters to the building. Tenjin's vacancy has also increased this half-year as a result of the addition of this building. However, with an impressive tenant list, the property looks on track to fill its vacant space.

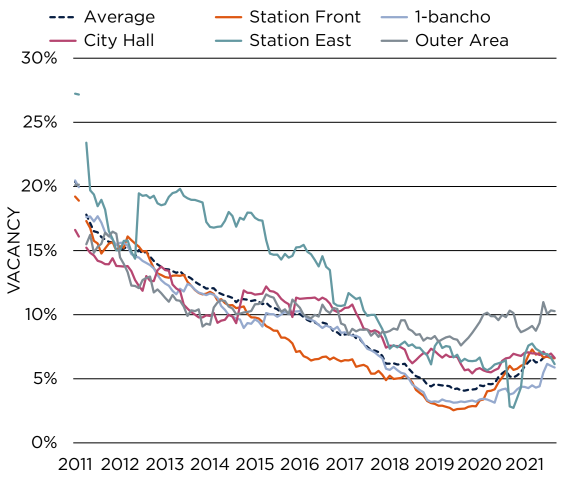
Outlook

The office market in Fukuoka has fared well during the pandemic without much deterioration. Vacancy remains tight and rents continue to climb. Indeed, the strong performance of Tenjin Business Center is a good sign for future supply. Furthermore, the secondary vacancy caused by the large supply over the last year appears manageable.

Looking ahead, the supply in 2022 looks promising given the strong absorption of 2021's large supply, although there are some concerns over the large Fukuoka Daimyo Project in 2022. Fortunately, with the lifting of the state of emergency and the plummeting COVID-19 cases, site visits for potential tenant moves are picking up while plans for office renovations also resuming.

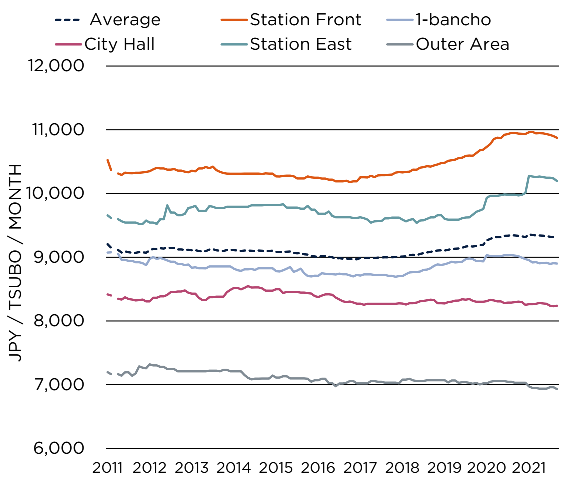
The new supply over the coming years is expected to revitalise the city by creating new landmarks and adding vibrancy to prime areas. Furthermore, the extension of the Nanakuma Line from Hakata to southern Tenjin will also improve the connection between central Fukuoka and Tenjin, which should lead to increased footfall in the two areas. Large international firms, such as Google and Boston Consulting Group, have recognised the growing potential in Fukuoka and have set up offices there. While there are some concerns surround the potential threat of new COVID-19 variants, Fukuoka's prospects look good overall.

GRAPH 17: Vacancy Rate in Sendai City by Area, 2011 to Q3/2021



Source Miki Shoji, Savills Research & Consultancy

GRAPH 18: Average Rent in Sendai City by Area, 2011 to Q3/2021



Source Miki Shoji, Savills Research & Consultancy

TABLE 8: Miyagi Prefecture Key Macro Indicators

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

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

SENDAI CITY

Supply and Demand

The levels of office supply in Sendai have been relatively flat over the past decade. For instance, as of September 2021, Sendai's office NRA has only grown 2.0% since the beginning of 2011, and the market's overall supply remains below 500,000 tsubo of NRA. Nonetheless, this appears to be a manageable level for Sendai, as the supply has since been gradually absorbed, with vacancy levels decreasing from highs of around 20% at the start of the decade.

In contrast to the previous decade, 2021 has been an active year for the market, and NRA has grown over 1.0% since the beginning of the year. Despite the pandemic, the large supply appears to have been well received. In fact, the two primary contributors, the JR Sendai East Building and the Milene T Sendai Building, experienced good pre-leasing activity before coming to the market. Looking ahead, 2023 looks to add a large amount of new supply close to Sendai station with the Yodobashi Sendai Dai-ichi Building project adding 23,000 sq m of office space in GFA.

Vacancy

Approaching the end of 2021, the all-grade vacancy rate in Sendai was at 6.5%, and has overall not seen significant changes over the past half-year. Nonetheless, the vacancy rate has increased more than 2.0ppts from the pre-COVID era in 2019, showing that the effects of the pandemic are still lingering in the city. It should also be noted that Sendai is the only city in this report whose vacancy levels are as high as Tokyo.

Although vacancy has remained mostly flat, there were notable differences between the performance of each submarket. For instance, the 1-bancho and the Outer Area submarket saw increments in vacancy of 1.4ppts and 1.2ppts over the past half-year. These two submarkets have seen some tenants moving out because of weakening market conditions and some increases in telework, leading to the rise in vacancy.

Meanwhile, Station East saw a notable decline in vacancy of 1.6ppts to 6.1%. Although the submarket saw a large uptick in vacancy at the start of the year as a result of the JR Sendai East Building that introduced large new supply, it appears to have been steadily absorbed by the market, which led to the encouraging decline in vacancy. Station Front also saw a decline in vacancy of 0.7ppts from the past half-year despite the addition of the Milene T Sendai Building during the period, showing the resilience of the submarket.

Rent

Rents in Sendai have overall been steady over the past decade, growing modestly even into the pandemic. However, rents have weakened slightly over the past half-year, decreasing 0.5% YoY to JPY9,300 per tsubo. Indeed, the gradual toll from COVID-19 has started to slowly affect average rental levels despite the introduction of two large buildings with above-average rents.

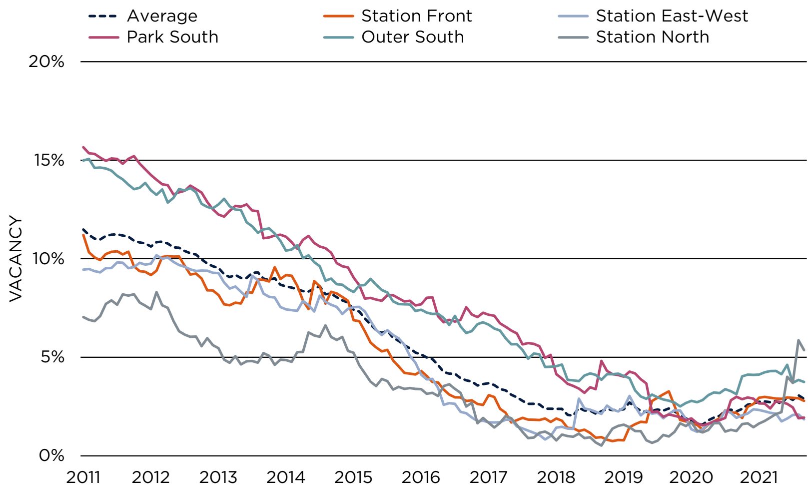
Station East was the only submarket to see rents increase over the year, growing 2.1% YoY. However, it should be noted that the addition of the JR Sendai East Building would have contributed to this growth. All other submarkets saw dips in rent ranging 0.7% to 1.4% YoY. Station Front rents remain the most expensive at JPY10,900 per tsubo, Outer Area rents are still the most affordable, at JPY6,900 per tsubo.

Outlook

Sendai's rents have seen their first annual correction since 2017, and vacancies still remain higher than pre-COVID times. However, Sendai has not been as overtly affected by the pandemic as Tokyo has. The fact that remote work is much less prevalent in the city than its larger counterparts, and that the city has caught the attention of IT companies and call centres, are some factors that have helped to prop office demand up in the city.

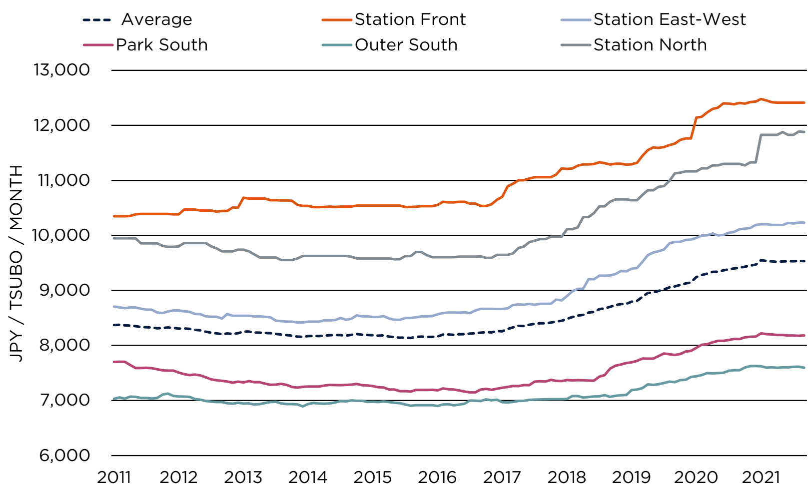
The demographic trajectory for Sendai is admittedly worrying for the city with its ageing population. In fact, its working-age population is projected to shrink more rapidly than other major regional cities. Nonetheless, Sendai has started making headway with the Sendai City Reconstruction Project, which aims to redevelop multiple old buildings in the city centre and create high quality offices to attract companies in the Information and Communications Technology industry. Indeed, it seems that a core strategy of the city's plans is to become an IT hub, and if successful, may create more jobs and attract people back into the city.

GRAPH 19: Vacancy Rate in Sapporo City by Area, 2011 to Q3/2021



Source Miki Shoji, Savills Research & Consultancy

GRAPH 20: Average Rent in Sapporo City by Area, 2011 to Q3/2021



Source Miki Shoji, Savills Research & Consultancy

SAPPORO CITY

Supply and Demand

Sapporo saw a substantial amount of new supply in 2021, with over 5,000 tsubo of NRA introduced to the market. Newer buildings around the main station and along Odori have found success, and many have opened with limited vacancy or were filled up soon afterwards. For instance, the largest new building this year, The Peak Sapporo, added over 3,000 tsubo of NRA in June and enjoys limited vacancy.

After a comparatively quiet year for supply in 2022, 2023 will see approximately 7,000 tsubo of NRA – one of the largest years for supply in the past decade. The two buildings to open in 2023, One Sapporo Station Tower and the Sapporo Daiichi Seimei Building, should perform well given that they will open near the main station where demand has been high. Call centres and IT companies in particular have continued to drive leasing demand in Sapporo.

Vacancy

All-grade vacancy has risen 0.6ppts YoY to 2.9%, the lowest vacancy rate amongst Japan's major regional cities. The vacancy increase seen this year was primarily due to the loosening in Station North where most of the new supply has been concentrated. Specifically, while The Peak Sapporo appears to be close to full occupancy, The Place Sapporo still seems to have considerable vacancy after opening in August. However, the situation looks to improve as the competition between tenants increases in other submarkets, such as Station Front, and increases in the number of inquiries have been reported.

TABLE 9: Hokkaido Prefecture Key Macro Indicators

	TOKYO	HOKKAIDO
Real GDP (JPY trillion) (FY2018)	105.9	19.7
Real GDP (YoY%)	0.5%	0.6%
% of Japan (FY2018)	19%	4%
Population (million)	14.0	5.2
Job to applicant ratio	1.2	1.0

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

All other submarkets have seen vacancy tighten, particularly in the more affordable submarkets, such as Park South and Outer South. Furthermore, the two large buildings that opened in 2020, S-Building Sapporo Odori and Daido Seimei Sapporo Building, seem almost fully occupied. Looking ahead, Station East-West, a submarket currently with under 2.0% vacancy, will be tested in 2023 as a large portion of supply that year will be concentrated in this submarket.

Rent

Although growth has slowed, rents have nonetheless seen an annual increment across all submarkets. Overall, Sapporo's average rents increased by 1.3% YoY to JPY9,500 per tsubo in 2H/2021. Indeed, with newer, more expensive buildings being added to the market, average rents are currently at their highest levels since the early 2000s. Furthermore, the city's various business initiatives seem to have also supported demand and helped this rental growth trend.

Rents in the Station Front submarket remain the highest in Sapporo at around JPY12,400 per tsubo. All other submarkets have experienced rental growth over the past half-year. Specifically, all-grade rents in Station North saw an increase of 5.1% YoY, most likely driven by the new redevelopments.

Outlook

Compared to other regional cities, Sapporo's business environment took less of hit from the pandemic. Sapporo's bread and butter for office leasing demand, call centres and IT-related companies, remain stable, although there are some concerns for both industries over the longer term. Overall, the current status quo appears to be manageable, especially with the high vaccination rates and the plummet in COVID-19 cases in the country.

Given that much of the current office stock was geared toward the 1972 Winter Olympics, Sapporo has some of the oldest stock amongst Japan's regional cities, with nearly 36% being built before the 1981 earthquake resistance regulation reform. Fortunately, multiple redevelopment projects are still underway in front of Sapporo Station and will help to revitalise the city in the long-term. Indeed, Sapporo City has introduced a development guidance policy for city centre redevelopments, and is also providing office building construction subsidies, which will help developers take full advantage of the new Shinkansen line that will come online in 2030.

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