Japan - December 2022

SPOTLIGHT
Savills Research

Regional Japanese Office Markets

savills

Stability in the market with some bifurcation

Summary

- Investment-grade offices have seen modest corrections in all regional submarkets. Vacancy loosened mildly in Osaka and Fukuoka, and tightened in Nagoya.
- All-grade office rental trends have varied across submarkets. Rents in Sapporo and Fukuoka increased, while others have mostly stayed flat.
- Cap rates for Grade A offices have experienced further tightening, indicating that investor appetite remains sound in the sector.
- Investment volumes in 2022 have been slightly lower than those of the same period in 2021, but a few large transactions were observed.
- Aside from Osaka, new supply has been limited in 2022, allowing markets to absorb available office space.
- Notable levels of supply are expected over the next few years, which might cause some fluctuations at the property level.

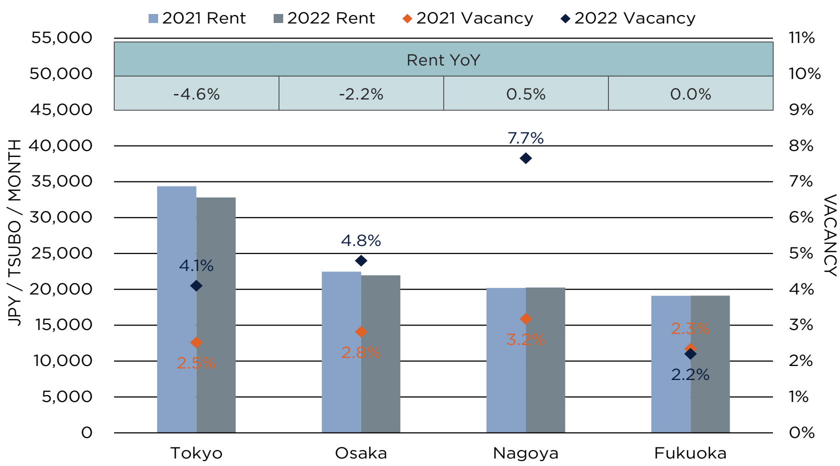
OVERVIEW

The recovery of the Japanese economy has started in earnest, and according to the quarterly Regional Economic Assessment conducted by the Bank of Japan in October 2022, most regional economies have experienced some moderate economic growth in 2022, which is encouraging for overall business confidence and office leasing activity.

Aside from Osaka, which saw a significant amount of new NRA arrive to the market in 2022, it was a quiet year for new office supply in Japan's regional markets. Given that most cities saw many new completions in 2021, 2022 has provided some breathing room to absorb the backlog of new offices. Overall, the situation has been positive for regional markets, although the notable upcoming supply scheduled for 2023 and 2024 in some markets might cause some disruptions in recovery going forward.

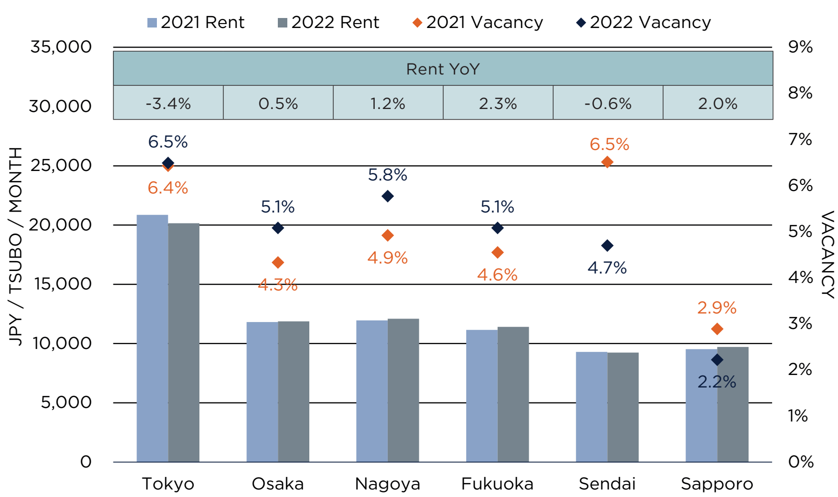
For investment-grade offices, average rents continued the slight downward movement in all regional markets over the past half year. Meanwhile, there were few changes to investment-grade vacancy over the past half-year - offices in Osaka and Fukuoka

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



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

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



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

experienced a mild increase in vacancy, while vacancy in Nagoya tightened. Nonetheless, vacancy levels in Osaka and Nagoya remain notably higher than a year ago.

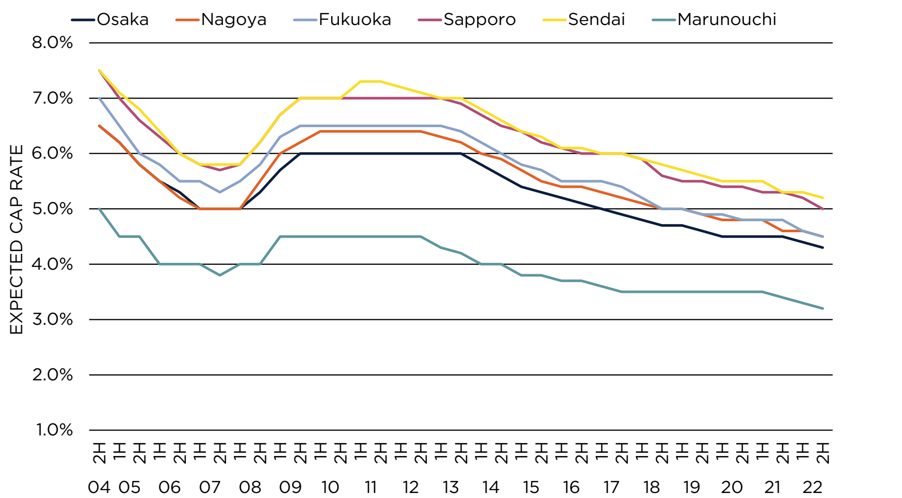
In terms of all-grade offices rents, changes in regional markets were nominal over the past half-year; Sapporo and Fukuoka saw moderate increments, while rents in Osaka, Nagoya, and Sendai stayed flat. Meanwhile, all-grade rents in Tokyo contracted by 1.0% HoH, slightly more than the regional average. Looking at vacancy, Sendai saw a tightening of 1.0 percentage points (ppts) HoH, while other markets either stayed flat or only saw minor changes over the past half-year.

The overall outlook appears to be stable, and only modest corrections were observed over the past half-year. Indeed adjustments stemmed primarily from the widening gap between overperformers and underperformers. The large supply scheduled for completion over the next few years may accelerate the bifurcation. Competition for tenants may result in the continued struggle of poorly priced and older properties.

REGIONAL INVESTMENT

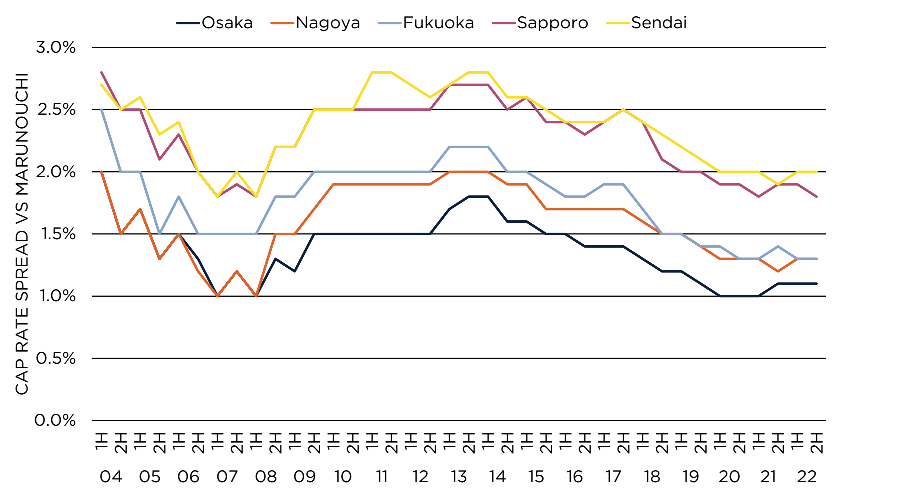
According to the bi-annual investor survey conducted by the Japan Real Estate Institute (JREI) in October 2022, expected cap rates in most regional markets tightened, with Sapporo decreasing by 20 basis points (bps), and those in Osaka, Nagoya, Fukuoka, and Sendai decreasing by 10bps from the previous half year. Meanwhile, expected cap rates in Yokohama remain unchanged. Tokyo's Marunouchi submarket also experienced some compression over the same period. Prices are elevated in most real estate sectors in Japan, and the further compression of expected cap rates demonstrates that investor interest is sound in the office sector.

GRAPH 3: Expected Cap Rates for Grade A Offices, 2H/2004 to 2H/2022



Source Japan Real Estate Institute, Savills Research & Consultancy

GRAPH 4: Expected Cap Rate Spreads (vs Marunouchi), 2004 to 2H/2022



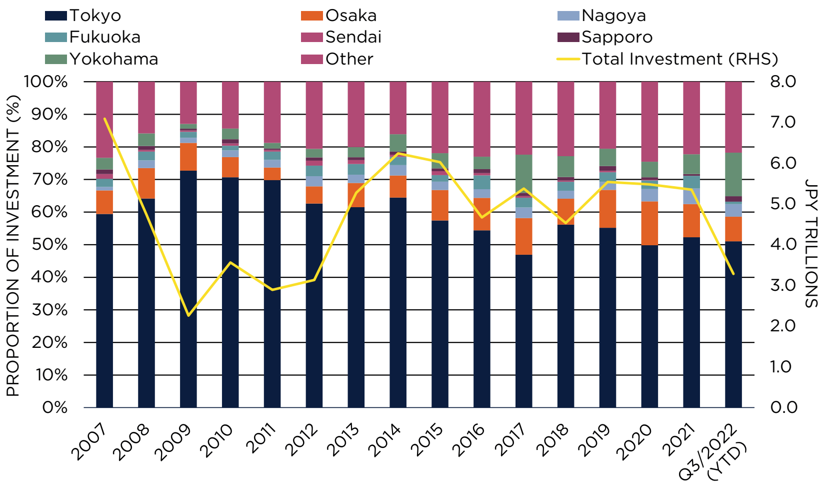
Source Japan Real Estate Institute, Savills Research & Consultancy

According to transaction data from Real Capital Analytics (RCA), total investment nationwide was around 15% lower in the first three quarters of 2022 compared to the same period in 2021. Similarly, transactions in the office sector contracted moderately by around 20%. That said, present figures for 2022 are preliminary, and are expected to increase as more transactions are confirmed.

Overall, investor appetite for office space in regional markets appears to have persisted. Sapporo saw an uptick in investment activity, bolstered by Global One REIT's acquisition of The Peak Sapporo for JPY17 billion. With new office completions set to increase in pace over the coming years in anticipation of the Hokkaido Shinkansen extension to Sapporo in 2030, investment activity should be strong going forward, particularly in the vicinity of Sapporo station.

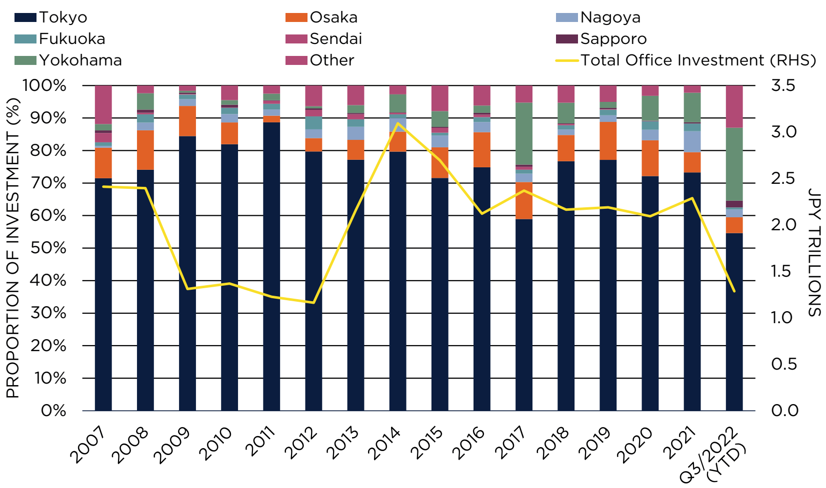
There has been some activity among domestic players over the past half-year. For instance, Mori Trust Sogo REIT completed an asset reshuffle involving the purchase of a

GRAPH 5: Investment Volumes by Area for All Asset Types, 2007 to Q3/2022



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

GRAPH 6: Investment Volumes by Area for Office Assets, 2007 to Q3/2022



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

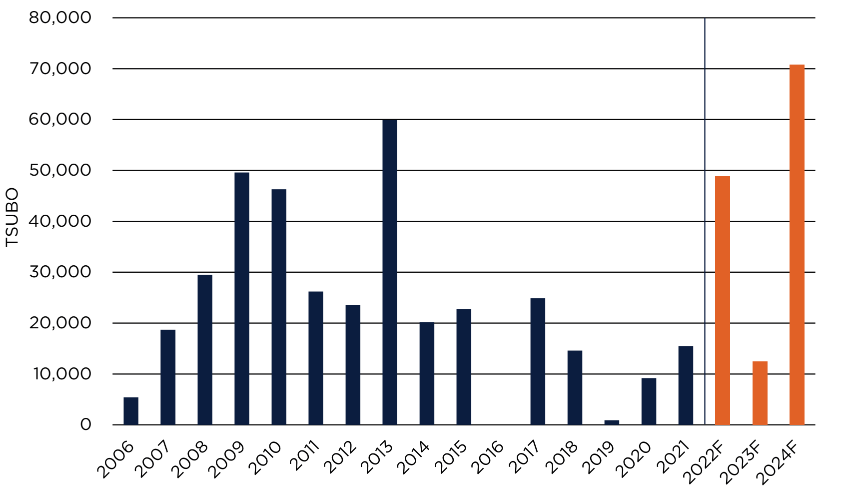
90% co-ownership interest in the Sendai MT Building in Sendai for around JPY16 billion from its sponsor Mori Trust. Transactions by international buyers have been somewhat limited in the regional office market, but some big-ticket deals have been observed in 2022. Notably, M&G Investments purchased the Minatomirai Center Building in Yokohama for over JPY100 billion from Hulic. However, the worldwide economic slowdown and interest rate hikes could possibly delay some transactions going forward.

OUTLOOK

Overall, there have been relatively few changes over the past half-year and office performance in regional cities has generally been more stable than in Tokyo. The addition of some new offices with high asking rents has not notably impacted vacancy rates, and it appears that most markets are absorbing the new supply well. Indeed, hybrid work styles are much less prevalent in regional markets when compared to Tokyo, so office utilisation has remained consistent.

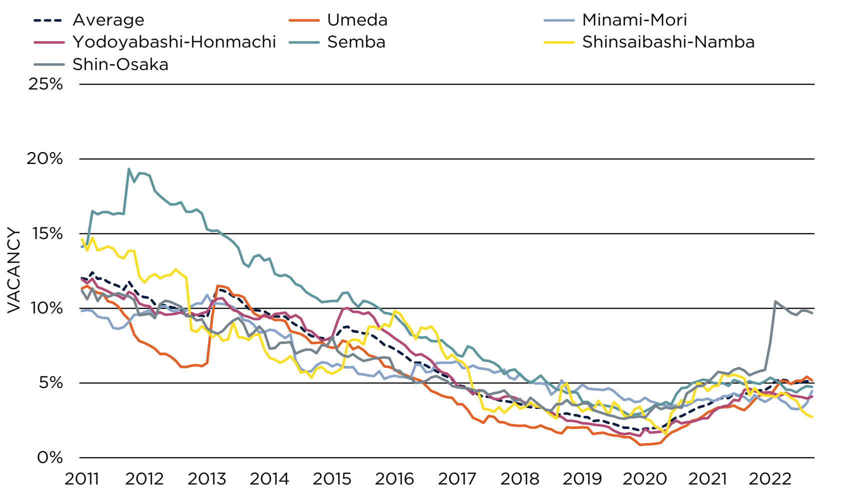
While the office market has demonstrated resilience and stability, the large upcoming supply over 2023 and 2024 could cause some stratification between performance at the property level. Indeed, some major quality developments have experienced lukewarm pre-leasing, while others in the same market have been well absorbed at the same time. Hence, while regional office markets are set to see further recovery with stable rents and occupancy going forward, there is a likelihood of some fluctuations occurring, depending on the leasing performance of certain major developments over the next few years.

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



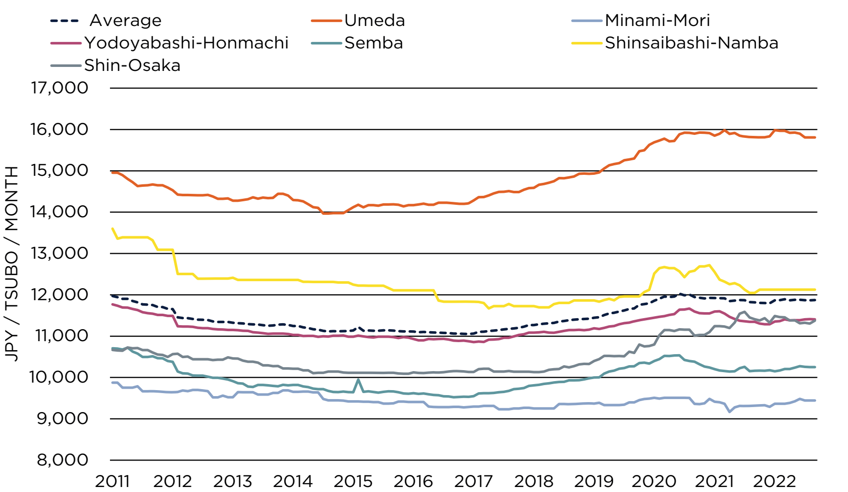
Source Sanko Estate, Savills Research & Consultancy

GRAPH 8: Vacancy Rate in Osaka City by Area, 2011 to Q3/2022



Source Miki Shoji, Savills Research & Consultancy

GRAPH 9: Average Rent in Osaka City by Area, 2011 to Q3/2022



Source Miki Shoji, Savills Research & Consultancy

OSAKA CITY

Net Rentable Area (NRA)

2022 was a notable year for Osaka, with around 50,000 tsubo of new office space to be added to the market. Despite the large amount of new supply, market conditions have been stable. For instance, vacancy in the Umeda submarket only experienced a minor fluctuation even with the large supply. Meanwhile, the Nippon Life Yodoyabashi Building came to the market this summer largely pre-leased, and currently appears almost full, demonstrating an appetite for new office space.

The relatively low supply forecast for 2023 will allow more time for leasing demand to recover and absorb new supply. That said, new developments scheduled for completion in 2024 will deliver an additional 70,000 tsubo of new office space around Osaka station, and there are concerns that the market may not be able to smoothly absorb the new supply of high-quality buildings expected to be priced at JPY38,000 per tsubo.

Vacancy

Investment-grade vacancy rates loosened slightly by 0.5ppts HoH to 4.8% in 2H/2022. Several newly constructed office buildings remain largely vacant in the Shin-Osaka submarket, which had an outsized impact on this upward movement. Meanwhile, there were a few large properties in the Umeda submarket with above-average vacancies. That said, the majority of submarkets continue to have low vacancy levels.

All-grade vacancy rates have fallen slightly by 0.1ppts over the past half-year to 5.1%. Vacancy has either remained flat or declined in most submarkets, with the exception of Minami-Mori, as well as the adjacent Umeda submarket, where the concentration of new buildings resulted in a moderate loosening in vacancy.

Rent

Rents in investment-grade offices have continued a downward trajectory, falling 0.7% HoH to JPY22,000 per tsubo. Many older properties across most submarkets saw moderate rental revisions, likely in order to remain competitive amidst the introduction of several new developments to the market.

All-grade rents have declined slightly, falling 0.2% HoH to JPY11,850 per tsubo. The largest contraction was seen in the Umeda submarket, where average rents declined

TABLE 1: Osaka Investment-grade Offices

	2H/2022	HOH	YOY
Rent	22,000	-0.7%	-2.2%
Vacancy	4.8%	+0.5ppts	+2.0ppts
Top Rent	38,000	0	+3,000

Source Savills Research & Consultancy

by 1.0% HoH to JPY15,800 per tsubo. Despite the slight contraction, Umeda has significantly higher average rents compared to other submarkets and retains notable leasing demand.

Umeda

Rents for investment-grade offices in the Umeda submarket experienced a moderate contraction by 2.0% HoH to JPY25,100 per tsubo. Rental corrections took place in a number of older properties, located far away from Umeda station, in order to remain competitive. Meanwhile, many high-quality, well-located offices saw little fluctuation and their high average rents are a testament to the latent demand in the Umeda submarket.

Yodoyabashi-Honmachi

Rents for investment-grade offices in the Yodoyabashi-Honmachi submarket experienced an increment of 0.9% HoH, reaching JPY23,200 per tsubo in 2H/2022. Meanwhile, investment-grade vacancy remained stable HoH at 3.8%.

The major addition to the submarket in 2022 was the Nippon Life Yodoyabashi Building, which had impressive pre-leasing activity.

Going forward, the submarket will see notable development activity in 2023 and 2024. The largest new addition will be the Urbannet Midosuji Building in early 2024, with 7,000 tsubo of NRA set to be delivered to the market. Although the submarket appears to be performing well, there are some concerns as to how smoothly the submarket will be able to absorb the upcoming large supply.

Shin-Osaka

Investment-grade rents for offices in the Shin-Osaka submarket experienced a moderate contraction at 1.5% HoH to JPY19,100 per tsubo. Indeed, the situation remains bleak in Shin-Osaka. The rental contraction implies that building owners have responded to the market by lowering asking rents to attract new tenants.

Leasing activity has been visible over the past half-year, with some entering into new leasing contracts in existing buildings. However, this was overshadowed by the poor pre-leasing activities of a majority of the newly completed properties in early 2022.

Outlook

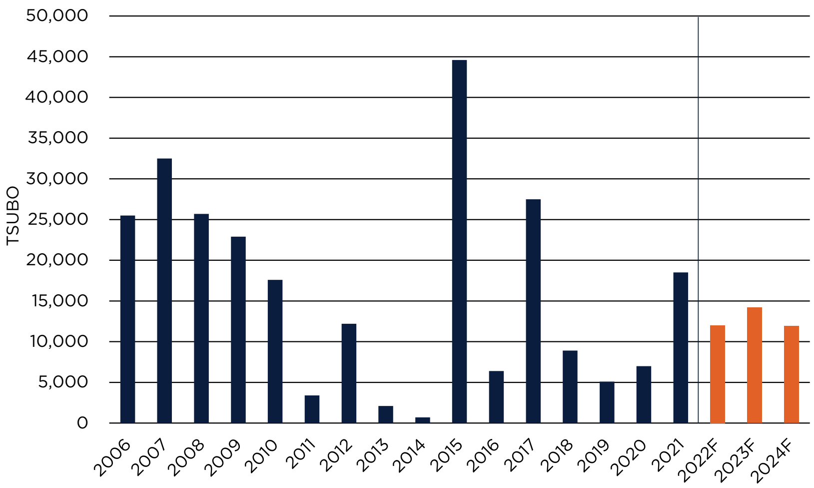
Overall, the Osaka office market has rebounded moderately, and there are optimistic signs of growth going forward. Although investment-grade rents declined slightly over the past half-year, the addition of new high-quality developments, especially in 2024, are likely to increase average rents over the coming years. That said, some disruptions are possible due to the large upcoming supply, and there are uncertainties as to how the Osaka market will receive it.

The Umeda submarket has experienced some fluctuation due to the arrival of Osaka Umeda Twin Towers South in 2022. This office has performed well, but there are some questions as to whether the station front area will attract enough demand to accommodate similarly priced developments on a very large scale at the same time in 2024.

In contrast, the situation in Shin-Osaka continues to be bleak. Average asking rents fell over the past half-year, and the submarket appears to be contracting towards a new equilibrium price point. Also, there will be more new supply in early 2024.

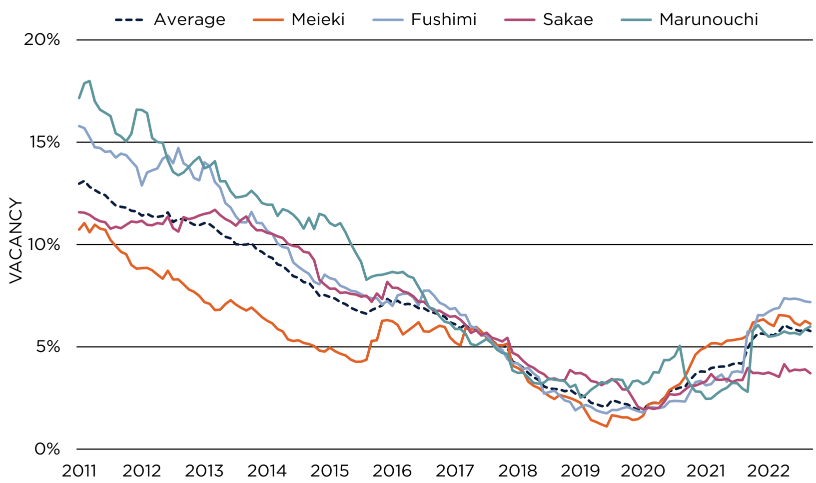
So far, there are few rumours regarding possible tenants for new supply in 2023, which give the impression of weak pre-leasing activity. Although the new supply set for 2024 is receiving some interest, it will likely take some time to absorb, given the large total size. That said, inbound tourism resumed, with Expo 2025 and IR in sight, the Osaka market is likely to keep growing.

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



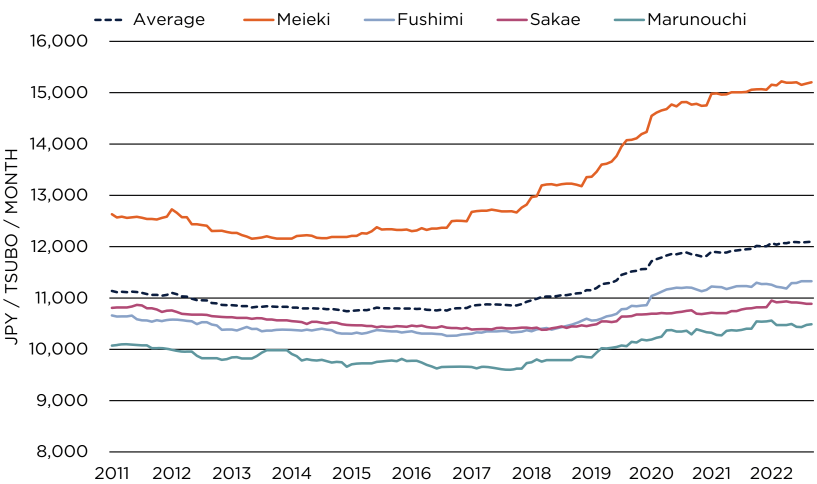
Source Sanko Estate, Savills Research & Consultancy

GRAPH 11: Vacancy Rate in Nagoya City by Area, 2011 to Q3/2022



Source Miki Shoji, Savills Research & Consultancy

GRAPH 12: Average Rent in Nagoya City by Area, 2011 to Q3/2022



Source Miki Shoji, Savills Research & Consultancy

NAGOYA CITY

NRA

Some new office supply has been received well, judging by the stability of vacancy rates over the past half-year. The 5,000 tsubo Urbannet Nagoya Nexta Building in the Sakae submarket is full, although the Nagoya Building Sakura-kan to the west of Nagoya station, which brought over 2,000 tsubo of new NRA to the market, still has a large amount of vacant space despite being completed over half a year ago. Furthermore, pre-leasing activity for much of the upcoming supply appears lukewarm, suggesting that location and pricing will continue to play an outsized role in determining which buildings are able to fill floors in the present market.

Looking ahead at 2023 and 2024, the annual new office supply is set to be around similar levels as 2022, with some standout developments scheduled to be built in Nagoya's prime submarkets. In 2023, the most notable project will be the 10,000 tsubo Chunichi Building in the Sakae area, and pre-leasing for this building appears to be going well, which is a strong sign for the market. In 2024, the 8,500 tsubo Nagoya Marunouchi 1-Chome Project is scheduled for completion. Overall, economic recovery will play a crucial role in how well new supply is received going forward.

Vacancy

Investment-grade office vacancy in Nagoya has tightened by 0.3ppts HoH to 7.7%. Little has changed over the past half-year and a majority of properties in each submarket in Nagoya have low levels of vacancy. That said, the market average is skewed by certain individual properties with outsized vacancies, which are likely in need of rental adjustments going forward.

All-grade market vacancy has been stable over the past-half year, remaining at 5.8%. The Meieki submarket witnessed some tightening, with vacancy decreasing by 0.5ppts HoH to 6.1%, and was the only submarket where vacancy fell. As economic recovery progresses and office demand returns, the station area will likely gain more attention due to its convenient transport links. On the other hand, vacancy loosened by 0.3ppts HoH in the Fushimi area, which features the highest vacancy levels at 7.2%. Meanwhile, Sakae's vacancy of 3.7% is the lowest among its peer submarkets, but also experienced a slight loosening by 0.2ppts HoH.

TABLE 2: Nagoya Investment-grade Offices

	2H/2022	HOH	YOY
Rent	20,300	-0.5%	0.5%
Vacancy	7.7%	-0.3ppts	+4.5ppts
Top Rent	35,000+	0+	0+

Source Savills Research & Consultancy

Rent

In 2H/2022, investment-grade office rents saw a moderate contraction of 0.5% HoH to JPY20,300 per tsubo. A majority of this downward movement was observed in a few newly completed buildings with high levels of vacancy. Otherwise, most buildings have seen rents stay flat over the past half-year, reflecting the stability of the Nagoya office market.

Meanwhile, all-grade rents remained flat over the past half-year at JPY12,100 per tsubo. Meieki has the highest rents in Nagoya, which remained flat over the past half-year at JPY15,200 per tsubo. Rents in Sakae also remained flat HoH. Meanwhile, Fushimi rents inched up by 0.9% HoH to JPY11,300 per tsubo.

Meieki

Meieki's investment-grade office rents contracted slightly by 0.7% HoH to JPY27,500 per tsubo. Meanwhile, investment-grade vacancy tightened by 0.2ppts HoH to 5.0%. Average rents have been stable in a majority of investment-grade offices in Meieki, and the slight fluctuation in average submarket rents can be attributed to rental revisions in the newly completed Nagoya Building Sakura-kan. Indeed, the property came to the market largely vacant in early 2022, and has not seen much progress over the year.

Going forward, the anticipated Enishio Meieki (formerly the Meieki 4-Chome OT Project) will deliver over 3,000 tsubo of new NRA to the Nagoya Station front area in 2023, in addition to the nearby 4,000 tsubo Dai Ni Nagoya Mie Kotsu Building slated for completion in 2024. Disruptions in global trade and depressed business sentiment may contribute to some fluctuations in Meieki over the coming years.

Fushimi and Marunouchi

Investment-grade office rents in Fushimi were stable over the past half-year, while rents in Marunouchi decreased by 1.4% HoH to JPY16,200 per tsubo in 2H/2022. Meanwhile, investment-grade vacancy tightened in both submarkets. In Fushimi, vacancy decreased by 1.8ppts HoH to 15.3%, while Marunouchi tightened 2.9ppts HoH to 9.3%. Although a few properties retain vastly higher vacancy levels than others in the Fushimi and Marunouchi submarket, a majority of properties are performing well.

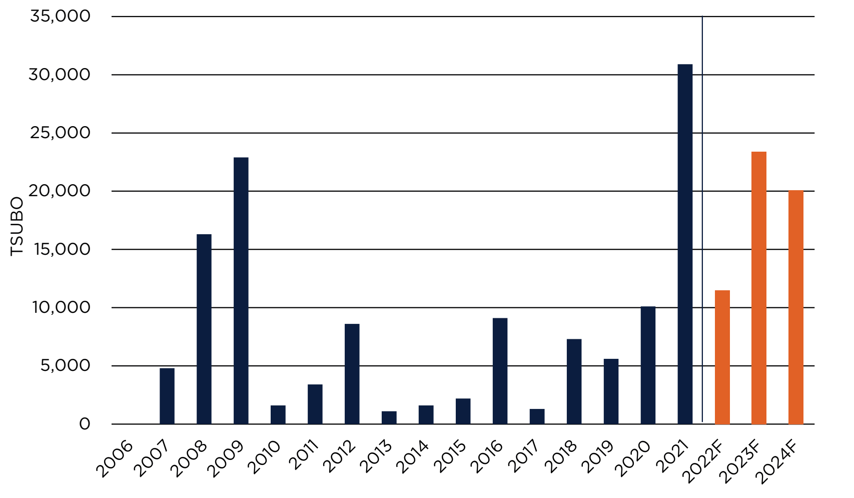
Outlook

2022 has been a quiet year thus far for Nagoya. Investment-grade rents and vacancy remain consistent, and this year has allowed for some breathing room to absorb recently added NRA. With only a few major developments in the pipeline for 2023 and 2024, the office market situation in Nagoya should have more time to stabilise further. As such, we expect few changes in rental levels and some further tightening in vacancy going forward.

Despite the stable outlook, leasing performance may continue to vary at the individual property level. For instance, the encouraging pre-leasing activity of the Chunichi Building demonstrates that demand is sufficient in Nagoya to absorb high-quality buildings with preferable features. Meanwhile, other buildings may still struggle to attract tenants, stemming from poor proximity and incorrect pricing.

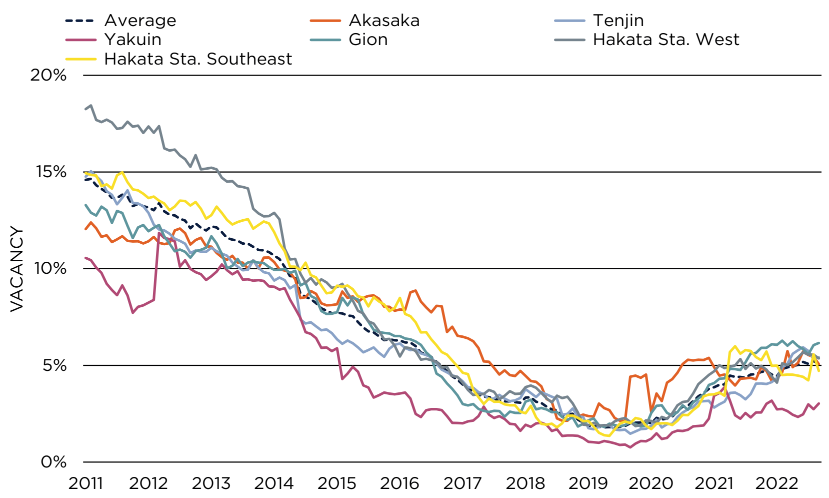
Supply chain disruption and elevated energy prices do little to ease business sentiment, which may cause some issues for further recovery in the office market. Overall, it appears that the Nagoya office situation will be stable, with any further recovery being moderate in the coming year.

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



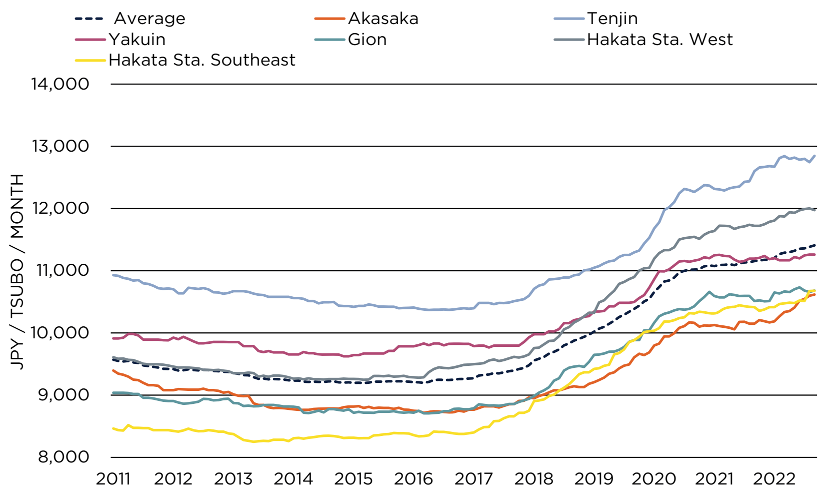
Source Sanko Estate,Savills Research & Consultancy
*2023 figure accounts for delay in completion of Fukuoka Daimyo Garden City.

GRAPH 14 Vacancy Rate in Fukuoka City by Area, 2011 to Q3/2022



Source Miki Shoji, Savills Research & Consultancy

GRAPH 15: Average Rent in Fukuoka City by Area, 2011 to Q3/2022



Source Miki Shoji, Savills Research & Consultancy

FUKUOKA CITY

NRA

Fukuoka has continued to absorb some of the large supply from 2021 as well as 2022 fairly well, including the Hakata East Terrace which recently delivered over 6,000 tsubo of NRA. While a large amount of supply is forecast for 2023 and 2024 as well, the improving economic circumstances and amicable reception to recently completed offices creates some optimism for the overall market.

Fukuoka Daimyo Garden City was originally set for completion in December 2022, with a very large 10,000 tsubo of NRA. Its pre-leasing activity is rumoured to have been lukewarm, and there is concern over an overall increase in vacancy. However, delays in its development are likely to postpone its opening, meaning that it could arrive to the market only in mid-2023. This is likely to prove serendipitous for the wider Fukuoka office market, as the overall vacancy levels should remain stable for the rest of the year. Furthermore, this also allows more time to absorb current supply and lessen potential fluctuations.

Vacancy

Investment-grade vacancy increased by 0.8ppts HoH to 2.2%, partially stemming from the addition of the new Hakata East Terrace, which came to the market with some vacant space. Nonetheless, the market has notably lower vacancy levels than regional peers and Tokyo, and looks to be doing well as a whole.

The all-grade market saw average vacancy rates inch up 0.2ppts HoH to 5.1%. Most submarkets saw slight increments in vacancy over the past half-year ranging between 0.2ppts and 0.4ppts. On the other hand, the Akasaka submarket saw vacancy improve, tightening 0.6ppts HoH to 5.1%, although it remains 0.8ppts higher than a year ago.

Rent

In 2H/2022, investment-grade rents in Fukuoka were stable, staying flat at JPY19,100 per tsubo. At the property level, while some buildings, especially older ones, saw mild corrections, other newer ones saw increments in rent, showing some similar diverging trends that we have seen in other cities.

All-grade rents in Fukuoka increased 1.0% HoH to JPY11,400 per tsubo, which are record high rents for the city. The greatest increment was experienced in Akasaka,

TABLE 3: Fukuoka Investment-grade Offices

	2H/2022	HOH	YOY
Rent	19,100	0.0%	0.0%
Vacancy	2.2%	+0.8ppts	-0.1ppts
Top Rent	30,000	0	0

Source Savills Research & Consultancy

where rents increased 2.7% HoH. Meanwhile, rents in Tenjin stayed flat over the past half-year, although they still remain 2.0% higher than the previous year.

Hakata

Rents of investment-grade buildings in Hakata increased by 1.4% HoH to JPY20,700 per tsubo, with rents ranging between JPY15,000 and JPY27,000+ per tsubo. Vacancy has increased slightly to 1.7%, which can partly be attributed to the addition of the Hakata East Terrace. That said, Hakata's fundamentals appear to be strong, and the submarket should remain stable going forward.

Hakata will see some notable completions of new office buildings in 2023 and 2024. For instance, there will be two new office developments in the west side of Hakata station in 2023. In the east side, an office building on the site of a former government building will be developed with around 3,500 tsubo of NRA in 2024.

Tenjin

Rents of Tenjin's investment-grade buildings have declined slightly by 0.3% HoH to JPY21,300 per tsubo, with a handful of buildings seeing mild rental corrections. Meanwhile, vacancy improved, tightening by 0.7ppts to 4.0% HoH. This improvement in fortunes was partly contributed by Tenjin Business Center having filled its vacant space.

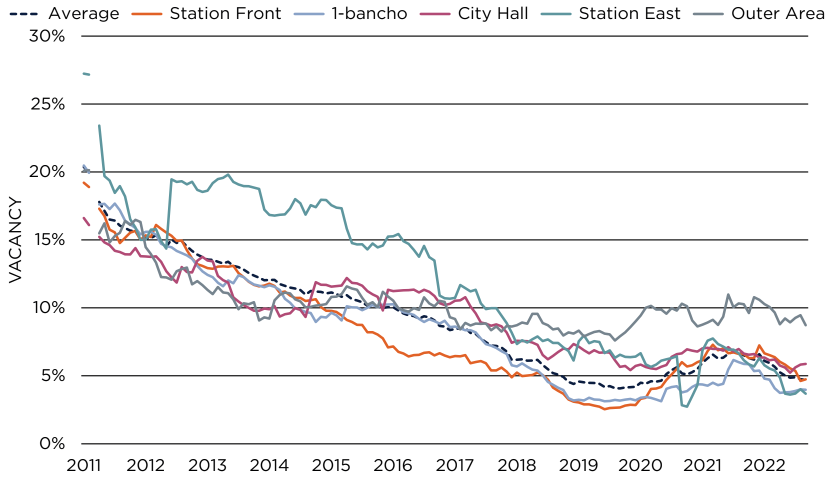
Looking ahead to 2024, the Tenjin submarket will welcome a few major additions. The Fukuoka Building is the most notable development, which will add 14,000 tsubo of NRA to the market. Despite its large size and relatively high rents of JPY32,000+ per tsubo, it has received significant interest, which is a strong sign for the market. Meanwhile, Hulic is also looking to complete its B3/19F, mixed-use Hulic Fukuoka Building by late 2024, which is expected to feature six floors of office together with a hotel.

Outlook

Overall, Fukuoka's office market has improved slightly over the past half-year and there are causes for optimism. The market appears to be absorbing new supply well, and vacancy only increased slightly due to the addition of Hakata East Terrace. Furthermore, the rumoured delay of the Fukuoka Daimyo Garden City until early-to-mid 2023 provides further reassurance for the stability of the Fukuoka office market in 2022.

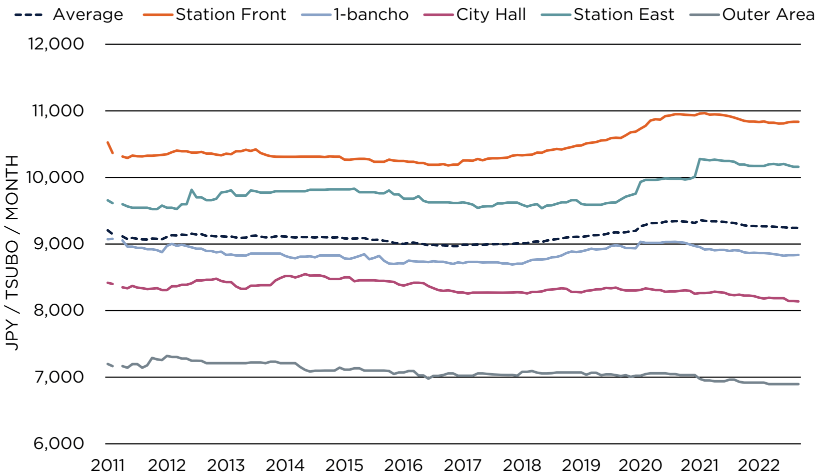
That said, concerns persist over the anticipated large supply in 2023 and 2024, which could potentially disrupt the current stable conditions, especially given rumours of lukewarm pre-leasing at the Fukuoka Daimyo Garden City. Indeed, some newer properties coming in 2023 appear to need to be less bullish with target rents in order to attract tenants. We do not hear many market rumours surrounding prospective tenants for these new buildings, which is not a promising sign. Nonetheless, with the encouraging pre-leasing of the Fukuoka Building, as well as the Tenjin Business Center having seen more tenants move in over the past half-year, Fukuoka should overall look to perform well.

GRAPH 16: Vacancy Rate in Sendai City by Area, 2011 to Q3/2022



Source Miki Shoji, Savills Research & Consultancy

GRAPH 17: Average Rent in Sendai City by Area, 2011 to Q3/2022



Source Miki Shoji, Savills Research & Consultancy

SENDAI CITY

Supply and Demand

There have been few additions in Sendai this year following the large amount of supply in 2021. Indeed, Sendai is gradually absorbing the previous year's large supply, with notable contractions in vacancy visible in the main submarkets throughout 2022.

Although 2022 has been a quiet year, 2023 will see an estimated addition of 15,000 tsubo of NRA, with the completion of the Yodobashi Sendai Dai-ichi Building project and the Urbannet Sendai-Chuo Building. Nonetheless, the positive absorption of recent new supply should be encouraging.

Vacancy

The all-grade vacancy rate in Sendai was 4.7% in Q3/2022, having tightened throughout 2022. Indeed, the 1.0ppts HoH tightening in vacancy seen in Sendai was the largest change experienced throughout all peer cities in Japan, and vacancy rates have recovered to pre-pandemic levels, aided by limited supply in 2022.

Improvements in vacancy were seen across all submarkets throughout 2022. In particular, the Station East submarket has been the best performing submarket over the past half-year, with vacancy falling 1.7ppts HoH to 3.7%. The Station Front submarket has also experienced a tightening of vacancy rates by 1.7ppts HoH to 4.7%. This is encouraging for new supply next year. That said, a disparity between submarkets persists in Sendai. Vacancy remains relatively high in the Outer Area submarket at 8.7%.

Rent

There was little fluctuation in average all-grade office rents over the past half-year in Sendai, with rents remaining unchanged at JPY9,250 per tsubo. Although average rents are still above pre-pandemic levels, there are signs of some gentle corrections taking place.

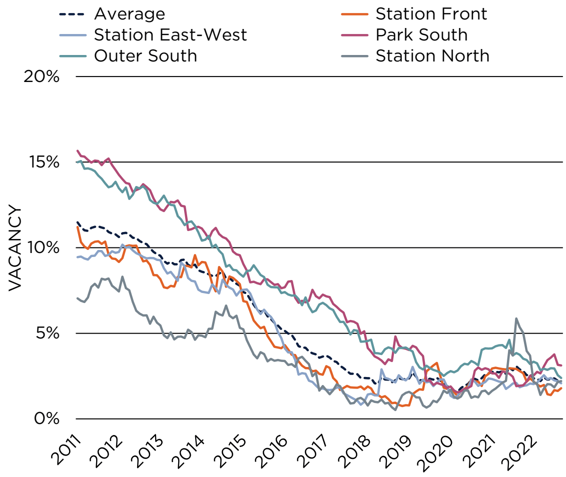
The Station Front and Station East submarkets remain the most expensive submarkets at JPY10,850 and JPY10,150 per tsubo, although the latter saw a 0.5% decline HoH. Meanwhile, the Outer Area submarket continues to feature the cheapest rents at JPY6,900 per tsubo, and experienced a 0.5% contraction YoY. The submarket is home to many SMEs, and sees frequent relocations of companies in the area.

Outlook

Overall, conditions appear favourable in Sendai. Rents have remained stable, and the city continued to steadily absorb supply added to the market in 2021. Vacancy has continued to decline, with little new office space being introduced in 2022, and has fallen to near pre-pandemic levels across most submarkets.

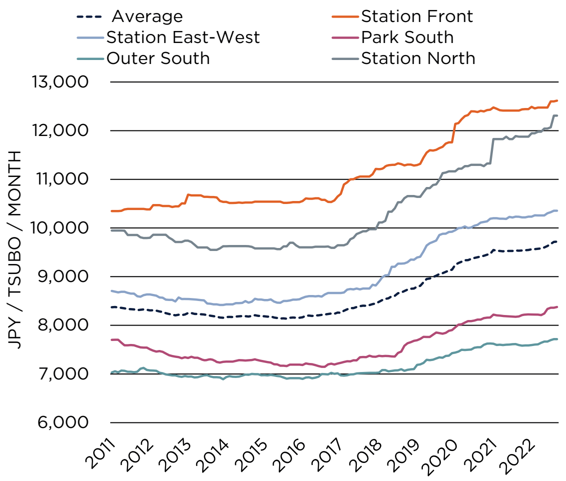
Going forward, Sendai will see high levels of new office space in 2023, concentrated in the central submarkets. This might cause some temporary fluctuations in vacancy rates, but the addition of high-quality offices could contribute to some upward movement in rents.

GRAPH 18: Vacancy Rate in Sapporo City by Area, 2011 to Q3/2022



Source Miki Shoji, Savills Research & Consultancy

GRAPH 19: Average Rent in Sapporo City by Area, 2011 to Q3/2022



Source Miki Shoji, Savills Research & Consultancy

SAPPORO CITY

Supply and Demand

In mid-2022, Sapporo 22 Square added around 1,500 tsubo of NRA to the market, and appears mostly occupied. The supply in Sapporo has been gradually increasing over the past few years, and a large amount is forecast for 2023 and 2024, which will both add approximately 10,000 tsubo of NRA to the market – the largest since 2007. Overall, the current strong performance in the Sapporo market is a good sign that the new upcoming supply could be received well.

Vacancy

All-grade vacancy in Sapporo stayed flat HoH at 2.2%. Average vacancy levels have been low and have nearly reached the tight levels seen in 2020, despite some new additions to the market in 2022.

Most submarkets saw some tightening in vacancy over the past half-year. The prime Station Front submarket again has the lowest levels of vacancy at 1.8%, having decreased by 0.1ppts HoH. Meanwhile, the Outer South and Station East-West submarkets saw vacancy fall to 2.4% and 2.1%, respectively. Overall, vacancy remains very low in Sapporo, which is a positive sign for the upcoming supply.

Rent

All submarkets in Sapporo have seen mild rental growth over the year for a second consecutive half-year, and increased by 1.5% to JPY9,700 per tsubo. This was the largest increment amongst major regional cities, and Sapporo has seen consistent growth in average rents throughout the pandemic.

All submarkets in Sapporo saw rental increments, the largest of which was in the second most expensive submarket, Station North, where average rents rose by 2.8% HoH to JPY12,300 per tsubo. The Station Front submarket features the most expensive rents, which increased by 1.1% HoH to JPY12,600. A series of new office developments are set for completion in 2023 and 2024 around the station area, and a modest increase in rents is expected going forward, due to strong demand for business relocations in the area.

Outlook

The Sapporo office rental market appears to have gone from strength to strength over the past half-year and is set to remain strong going forward. Vacancy levels are tight, and rents have continued to gradually increase. The market has absorbed new supply well and there are positive signs that new office developments in 2023 and 2024 are likely to be well received by the market. Indeed, there will be particular interest in the Sapporo station area going forward, where widespread redevelopment is taking place in anticipation of the Hokkaido Shinkansen extension.

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