Japan - December 2023

SPOTLIGHT

Savills Research

Regional Japanese Office Markets

savills

Moderate growth to continue, with some weaknesses in absorbing upcoming supply

Summary

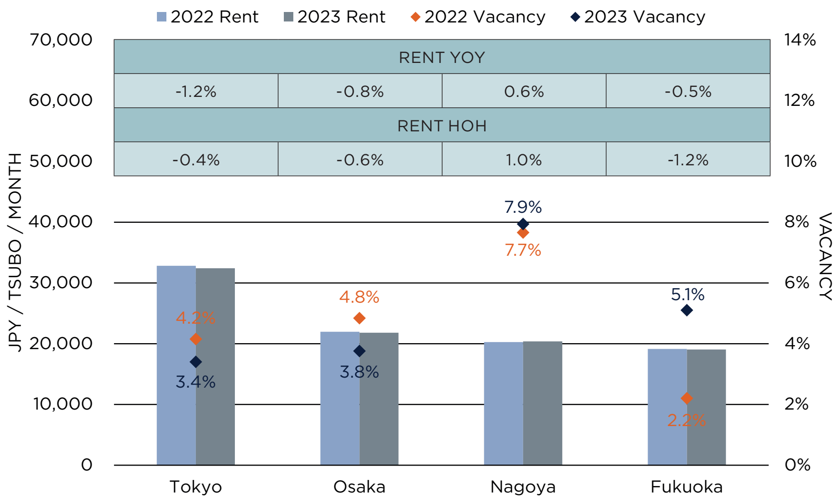
- Changes in the investment-grade office market have been moderate, with rents rising year-on-year (YoY) in Nagoya but contracting YoY in Osaka and Fukuoka. Meanwhile, vacancy loosened in Fukuoka and Nagoya, but tightened in Osaka.
- All-grade office rental performance was largely positive over the past year. Rents in Sapporo increased by a notable margin, while all other regional markets experienced moderate increments.
- Osaka and Sendai saw further cap rate compression in 2H/2023, and all other regional submarkets remain relatively tight.
- Year-to-date (YTD) investments in office assets as of Q3/2023 declined by nearly 40% compared to the same period in 2022, while overall transaction volumes also contracted at a milder rate of 20%.
- New supply has been moderate across most submarkets, but absorption appears to take more time. This was especially the case in Fukuoka, which welcomed particularly large amounts of new office space in 1H/2023.
- The spotlight will be on Osaka in 2024, with massive amounts of new office supply scheduled for completion. A majority of upcoming developments will have high target rents, and observers should expect noticeable fluctuations in the Osaka market.

OVERVIEW

The Japanese economy and society have largely returned to a state of normalcy throughout 2023. Although hybrid work arrangements remain in place amongst many large corporations across the country, the overall expansion of office participation, coupled with record corporate profits and improved business sentiment, are providing a much-needed boost to regional office markets. This bodes well for further growth in leasing demand, especially given the large influx of new office supply forecast for completion in 2024 that threatens to disrupt the current stable situation.

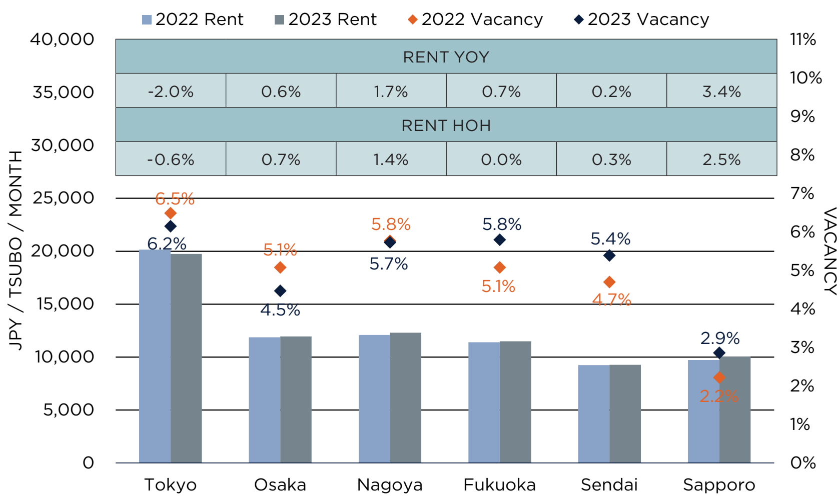
Completions have been moderate throughout 2023, but the reception of new developments appears to have been mixed. For instance, a handful of major new additions appear to have struggled to gain traction in Nagoya and Fukuoka, and the large upcoming new supply in both cities in 2024 may likely trigger some fluctuations as both cities deal with the existing backlog of vacant space. Meanwhile, relatively large amounts of new supply arrived in the Sendai and Sapporo markets in 2023, and a number of major developments exhibited elevated vacancies upon completion. That said, the resilience of both submarkets and limited available office stocks should ensure that new

GRAPH 1: Investment-grade Office YoY* and HoH Performance, 2H/2023**



Source Savills Research & Consultancy
#Tokyo data represents Grade A office performance in the C5W.
*YoY market data as of September 2022 and September 2023.
**HoH market data as of March 2023 and September 2023.

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



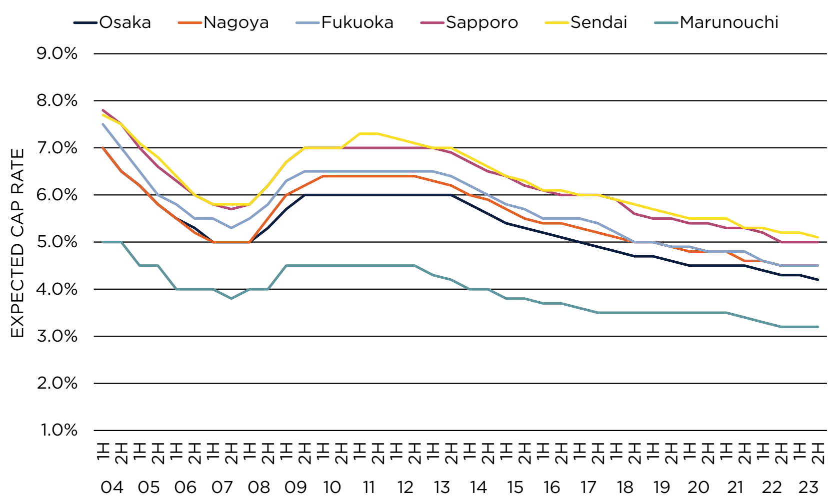
Source Miki Shoji, Savills Research & Consultancy supply is gradually absorbed with minimal issues moving forward.

The situation in Osaka appears challenging in 2024, with roughly 90,000 tsubo of NRA forecast for completion, of which a large proportion will be concentrated in the Umeda submarket. Many properties will likely experience heightened competition for tenants, especially as leasing demand appears yet to have fully recovered. Hence, several instances of price corrections have already been observed, with building owners looking to create a greater sense of affordability.

Furthermore, a combination of factors may delay and constrain new supply beyond 2025, including heightened construction costs, and the reassessment of development plans in response to lukewarm office demand, which should come as a welcome sign for certain markets that are struggling with vacancies.

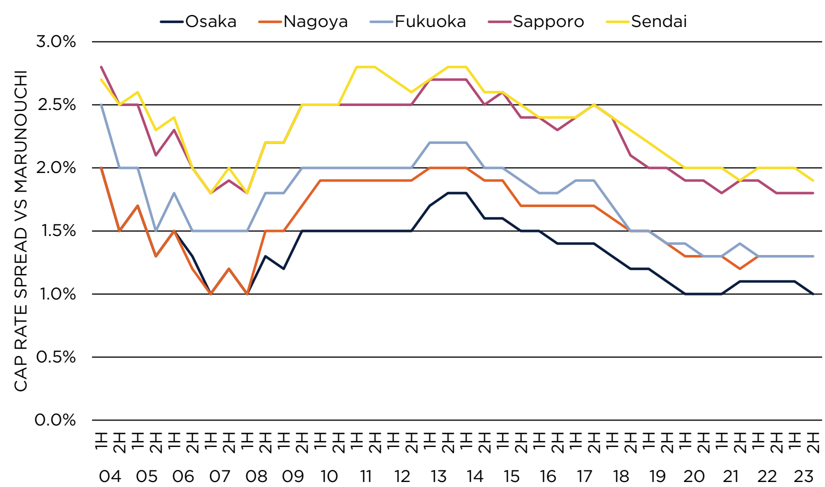
The performance of regional office markets in Japan continues to improve as overall business sentiment recovers and office participation increases. However, some concerns persist regarding the strength of leasing demand in certain markets, given the lukewarm absorption of some pricey new additions and the incoming large office supply in 2024, which may cause some disruptions in the market.

GRAPH 3: Expected Cap Rates for Grade A Offices, 2004 to 2H/2023



Source Japan Real Estate Institute, Savills Research & Consultancy

GRAPH 4: Expected Cap Rate Spreads (vs Marunouchi), 2004 to 2H/2023



Source Japan Real Estate Institute, Savills Research & Consultancy

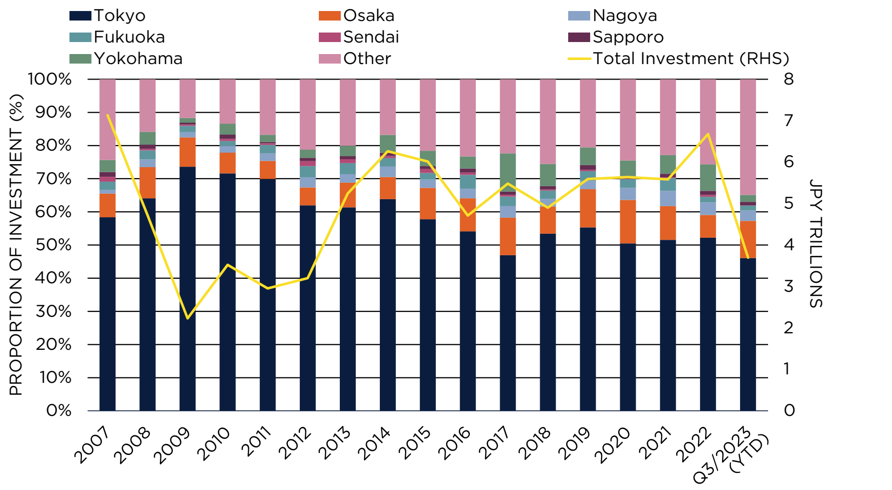
The investment-grade office market saw some mild divergence in performance over the past year. Average rents increased moderately in Nagoya, but contracted in Osaka and in Fukuoka. On the other hand, investment-grade vacancy tightened over the same period in Osaka, but loosened in Fukuoka, and also in Nagoya, where average vacancy has reached notably high levels at 7.9%. Although the recent economic recovery has supported demand for premium office space, sentiment looks to remain lukewarm in the investment-grade market. This is largely due to large new office supply, lingering hybrid work arrangements, and bullish rents of some newly completed properties.

For the all-grade office market, average rents displayed encouraging results over the past year. Sapporo was the standout performer with average rents having increased by 3.4% YoY. Elsewhere, all-grade rents increased moderately in all regional markets, while contracting moderately in Tokyo YoY. All-grade vacancy was similarly stable overall, despite some slight changes at the regional market level. Vacancy in Osaka and Nagoya tightened by around 0.6ppts and 0.1ppts over the past year, respectively, while other markets either remained unchanged or loosened marginally.

REGIONAL INVESTMENT

According to the bi-annual investor survey conducted by the Japan Real Estate Institute in October 2023, expected cap rates in Osaka and Sendai tightened marginally by 10 basis points (bps), and were unchanged in

GRAPH 5: Investment Volumes by Area for All Asset Types, 2007 to Q3/2023 (YTD)



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

the other surveyed regional office markets. Prices remain elevated across most real estate sectors in Japan, and the compressed expected cap rates demonstrate that investors still consider office assets in Japan a popular investment option.

According to initial transaction data from MSCI, total investment nationwide was around 20% lower in the first three quarters of 2023 compared to the same period in 2022. Similarly, transactions in the office sector have also experienced a decline of around 38%. That said, it is important to note that the present figures are preliminary and are expected to increase as more transactions are confirmed.

There have been a number of notable big-ticket office transactions over the past half-year in Japan's regional markets. For instance, the KDX Kawasaki-Ekimae Hon-Cho Building, which was sold by Kenedix Office Investment Corporation for JPY42.0 billion, was the largest deal over the past half-year. Another significant deal in Kawasaki was Japan Excellent REIT's sale of a 65% quasi co-ownership interest in the Kowa Kawasaki Nishiguchi Building, valued at JPY16.1 billion. Elsewhere, NTT UD REIT Investment Corporation acquired the Urbannet Shijo Karasuma Building in Kyoto and Urbannet Fushimi Building in Nagoya for JPY9.7 billion and JPY8.8 billion, respectively.

Cross-border investment activity in the first three quarters of 2023 declined sharply compared to the same period in 2022, according to MSCI. The sentiment in the western office market appears to have driven many overseas investors to sectors with sounder prospects, such as industrial and residential. Nevertheless, despite some hiccups in the office market over the past half-year, recovering economic sentiment across Japan's regional markets and the likely improvement in leasing demand should elevate the image of the office market among investors going forward.

OUTLOOK

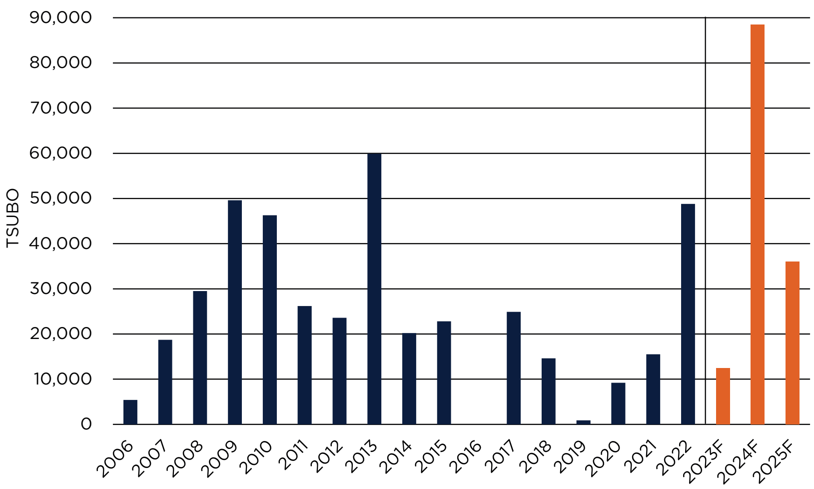
Moderate progress has been made across Japan's regional office markets over the past half-year, with overall absorption of new supply and rather limited secondary vacancies, aside from a handful of outliers. Japan's economy remains on a steady recovery trajectory, and office participation rates are expanding. That said, hybrid work arrangements appear to remain as an employee perk at large corporations, and some companies have looked to reduce their office footprints and relocate to more convenient but smaller office spaces as a result.

Looking ahead, large amounts of new office supply are forecast across the surveyed markets, which is likely to bring about some notable fluctuations, with upticks in both vacancies and rental rates anticipated. Furthermore, many large offices with high rents and those that are struggling with persistent vacancies may be required to adjust rents, especially in areas that are set to receive large amounts of new supply, such as Umeda in Osaka.

On the other hand, rising construction costs and labour shortages will likely continue to delay or compel developers to think twice about development projects over the coming years. Indeed, this may be viewed as a silver lining for regional office markets, giving struggling properties and submarkets some breathing room to deal with existing vacant space.

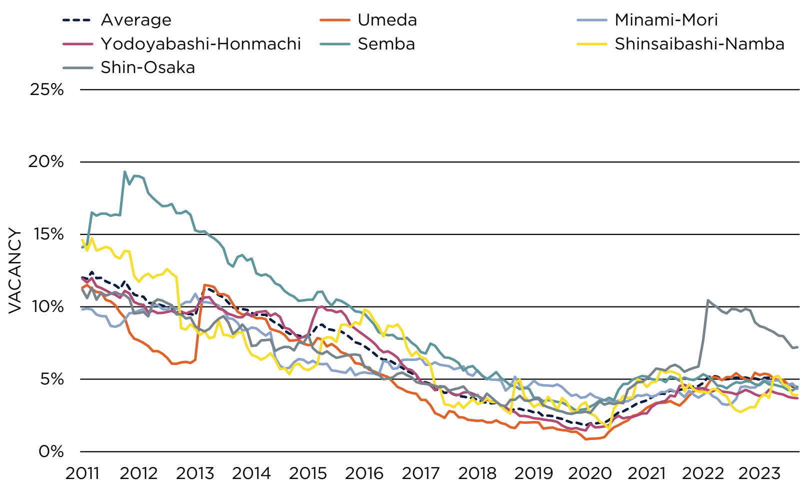
Overall, further growth should be anticipated in all regional markets over the coming years. Although the large upcoming new supply may cause some temporary disruptions, these major developments should improve the landscapes of each respective market in the medium- to long-term, which should help to attract businesses and residents, and improve the sentiment of the office sector and wider economic prospects across major cities.

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



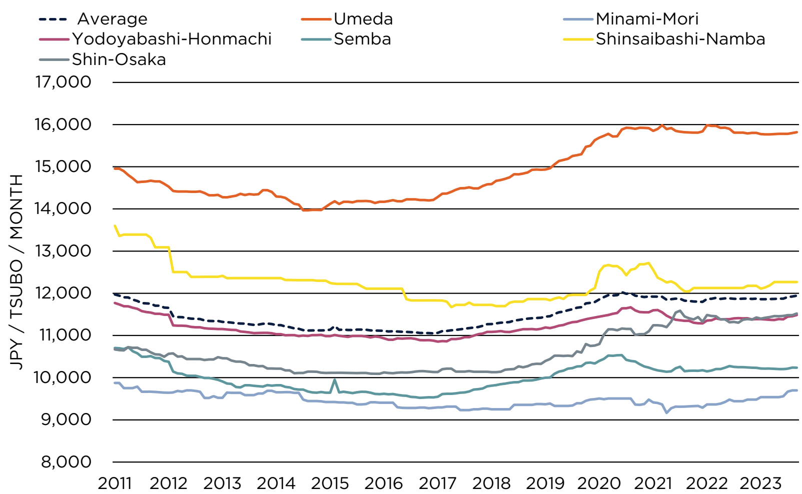
Source Sanko Estate, Savills Research & Consultancy

GRAPH 7: Vacancy Rate in Osaka City by Area, 2011 to Q3/2023



Source Miki Shoji, Savills Research & Consultancy

GRAPH 8: Average Rent in Osaka City by Area, 2011 to Q3/2023



Source Miki Shoji, Savills Research & Consultancy

OSAKA CITY

Net Rentable Area (NRA)

The second half of 2023 has not seen any notable new office building completions, which has created opportunities for absorption in Osaka, as evidenced by the decline in vacancy rates across most submarkets.

However, this stable market setting is expected to experience some hiccups moving forward. A significant new office supply of roughly 90,000 tsubo is anticipated for 2024, with more than half of this new supply concentrated in Umeda. In addition, a preliminary forecast of 35,000 tsubo of NRA is also scheduled for completion in 2025, largely focused in the Yodoyabashi and Honmachi submarkets. This projected large office supply is expected to induce a certain degree of disruption in the market.

Vacancy

Investment-grade vacancy rates tightened by 1.2ppts half-year-on-half-year (HoH) to 3.8% in 2H/2023. The Shin-Osaka submarket saw the largest decline in vacancies, although it is still the largest contributor among the submarkets. Vacancy remains tight across the market, although there are a few outliers with exceptionally high vacancy levels.

All-grade office vacancy rates fell by 0.6ppts over the past half-year to 4.5%, and vacancy tightened in most submarkets. Shin-Osaka saw the most notable change, decreasing by 1.2ppts HoH, although it remains elevated at 7.2%. Despite the gradual absorption of existing supply taking place over the past half-year, the large uptick in completions forecast for the coming half-year may cause some temporary fluctuations in the market.

Rent

Rents in investment-grade offices fell slightly by 0.6% HoH to JPY21,800 per tsubo. The overall investment-grade market seems to be stable, with only a handful of office buildings reducing their rents. Many of the large mixed-use developments in Umeda that comprise most of the supply in 2024 appear to have high target rents, which will likely drive up average investment-grade rents, but may contribute to some temporal instability in the market.

All-grade rents increased by 0.7% HoH to JPY11,950 per tsubo. Rents increased across all submarkets, with the largest rate of growth experienced by Minami-Mori and

TABLE 1: Osaka Investment-grade Offices

	2H/2023	HOH	YOY
Rent	21,800	-0.6%	-0.8%
Vacancy	3.8%	-1.2ppts	-1.0ppts
Top Rent	38,000	0	0

Source Savills Research & Consultancy

Yodoyabashi-Honmachi at 1.7% HoH and 1.0% HoH, respectively. The introduction of new high quality office space in 2024 will likely contribute to some notable growth in average rents, especially in the Umeda submarket.

Umeda

Rents for investment-grade offices in the Umeda submarket decreased slightly by 0.2% HoH to JPY24,800 per tsubo. Meanwhile, investment-grade vacancy tightened by 0.4%. Overall, 2023 has been a relatively quiet year, and the situation appears to be characterised by increasing stability. Although vacancy levels remain slightly elevated, particularly among larger buildings, due to a handful of large-scale cancellations over the past half-year, the strength of leasing demand for small and medium sized office properties, in conjunction with the limited new supply in 2023, suggests a stable trajectory for the meantime.

The spotlight will be on the Umeda submarket in 2024, with a huge volume of new office space scheduled for completion over the coming year – most notably the 35,000 tsubo Grand Green Osaka, and the 20,000 tsubo JP Tower Osaka. In particular, JP Tower is rumoured to be half pre-leased already. Given its location and modern specifications, it should perform well. However, other major developments may not fare so well, given their locations and project features. Indeed, there have been some hiccups in absorbing large offices over the past half-year, and observers will likely view the submarket with slight concern, with noticeable fluctuations expected over the coming year.

Yodoyabashi-Honmachi

Rents for investment-grade offices in the Yodoyabashi-Honmachi submarket decreased by 0.7% HoH to JPY23,500 per tsubo in 2H/2023. Meanwhile, investment-grade vacancy tightened by 1.4ppts HoH to 3.8%.

Two new office buildings are slated for completion around the start of 2024, the Urbannet Midosuji Building and the Midosuji Daibiru, introducing a combined 10,000 tsubo of new NRA into the submarket. In addition, the submarket is set to welcome an influx of over 30,000 tsubo of new office space with the scheduled completion of the twin Yodoyabashi Station redevelopment projects in 2025. The anticipated large increase in supply may cause some disruptions in the submarket, given the relatively slow absorption of recent new office space, exemplified by Honmachi Garden Terrace, where roughly half of the office space remains vacant.

Shin-Osaka

Investment-grade rents for offices in the Shin-Osaka submarket contracted 0.8% HoH to JPY18,800 per tsubo. Meanwhile, average investment-grade vacancy rates tightened sharply by 5.8 ppts HoH to 5.9% in 2H/2023.

The Shin-Osaka submarket did not witness any new completions over the past half-year, providing well needed breathing room for absorption, as evidenced by the significant tightening of vacancies. That said, Shin-Osaka still maintains the highest vacancy rates among the submarkets, with a majority of offices exhibiting some level of vacancy. Furthermore, the submarket is anticipated to welcome a new office development in early 2024, which will deliver an additional 3,000 tsubo of NRA, and could potentially interrupt the current positive trajectory.

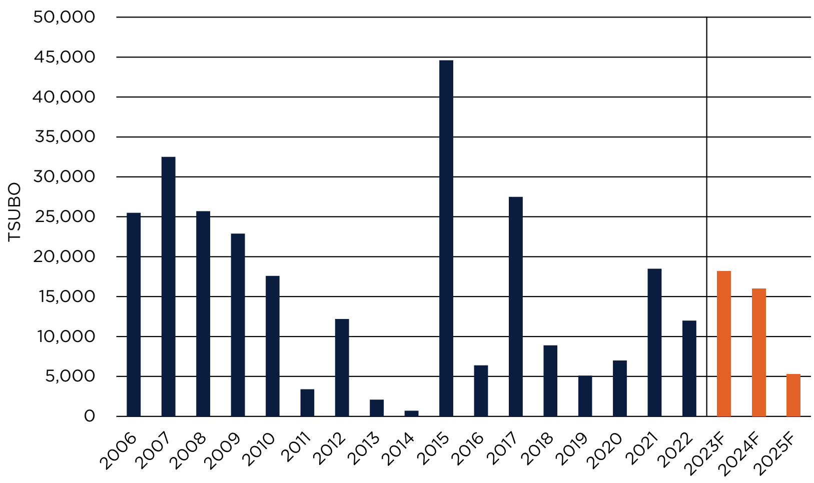
Outlook

Overall, the Osaka office market has seen healthy absorption of new supply in 2H/2023, with vacancies experiencing a decline across all submarkets, largely due to the limited new supply.

Looking ahead, the Osaka office market will see a large influx of new supply in 2024 and 2025, notably with the upcoming completion of the massive Grand Green and JP Tower Osaka in Umeda. While lukewarm demand has continued, it is unlikely to keep up with the looming large supply, potentially leading to a temporary increase in vacancies. Furthermore, new offices may face challenges in commanding high premium rents due to increased competition resulting from the impending supply surplus.

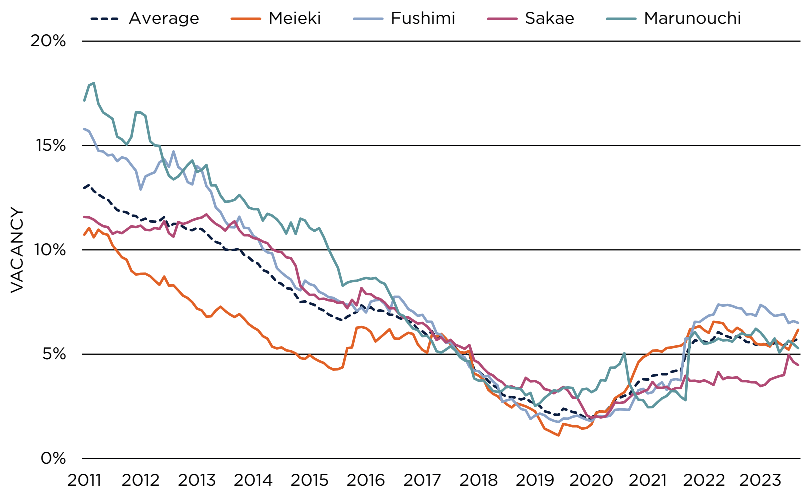
That said, the integration of Grand Green Osaka with Osaka Umeda Station and the creation of large public green space as part of the project will create a city-within-a-city environment and significantly improve livability and accessibility. Meanwhile, with the upcoming expo in 2025 and the integrated resort development, as well as a number of public transport improvements, Osaka will fundamentally transform itself, likely attracting more residents and businesses, and subsequently leading to greater leasing demand.

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



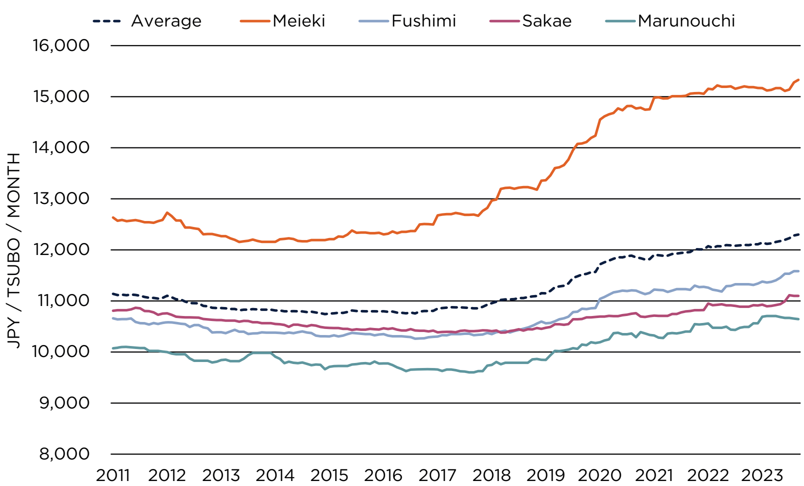
Source Sanko Estate, Savills Research & Consultancy

GRAPH 10: Vacancy Rate in Nagoya City by Area, 2011 to Q3/2023



Source Miki Shoji, Savills Research & Consultancy

GRAPH 11: Average Rent in Nagoya City by Area, 2011 to Q3/2023



Source Miki Shoji, Savills Research & Consultancy

NAGOYA CITY

NRA

Completions have picked up in the Nagoya market over the past half-year. The most notable addition was the 10,000 tsubo Chunichi Building in Sakae, which appears to have been fairly well received. Elsewhere, the 3,800 tsubo Enishio Meieki and the 3,000 tsubo Frontier Meieki arrived to the Meieki market with some vacancies, potentially due to bullish asking rents. Indeed, there are some concerns regarding the level of demand for such office space, especially at high price points.

While office developments scheduled for completion in central Nagoya between 2024 and 2025 are moderate in number, tentative forecasts for new supply in 2026 show a large uptick in development. In 2024, the Nagoya Shimizu Fukoku Life Building will deliver around 9,300 tsubo to the Marunouchi submarket, while the 3,900 tsubo Dai-ni Nagoya Sanko Building is scheduled for completion in the Meieki submarket. Overall, new office supply appears to be moderate over the next few years in Nagoya, which should prove favourable for the market, especially with the current lukewarm office leasing demand.

Vacancy

Investment-grade office vacancy in Nagoya increased notably by 1.4ppts HoH to 7.9% in 2H/2023. This loosening was largely due to a handful of properties that recently arrived to the market with large amounts of vacancy. That said, the Chunichi Building appears to be performing well so far.

All-grade market vacancy also increased slightly by 0.3ppts HoH to 5.7% in 2H/2023. Meieki and Sakae submarkets experienced some loosening, with vacancy increments of 0.8ppts HoH and 0.7ppts HoH to 6.2% and 4.5%, respectively. That said, the recovery of the Nagoya economy should bode well for vacancy performance in the post-pandemic era.

Rent

In 2H/2023, investment-grade office rents increased by 1.0% HoH to JPY20,400 per tsubo, amounting to a yearly increment of 0.6%. This rental growth stems from the addition of new office developments with above-average rents, namely the Chunichi Building and Enishio Meieki. That said, some further rental adjustments appear to be required in response to lukewarm demand among prospective tenants, especially

TABLE 2: Nagoya Investment-grade Offices

	2H/2023	HOH	YOY
Rent	20,400	1.0%	0.6%
Vacancy	7.9%	+1.4ppts	+0.2ppts
Top Rent	35,000+	0	0

Source Savills Research & Consultancy

given that a significant proportion of large office properties in Nagoya are now owned by large institutional funds that have been reluctant to adjust rents, consequently leading to high levels of vacancy.

Meanwhile, all-grade rents witnessed a moderate uptick across most submarkets in Nagoya in 2H/2023. All-grade average rents increased by 1.4% HoH to JPY12,300 per tsubo, and all grade rents are sitting comfortably above pre-pandemic levels. The Meieki submarket retains the highest all-grade rents at JPY15,350 per tsubo, while the Sakae and Fushimi submarkets experienced the largest half-yearly rental growth at 1.8%.

Meieki

Meieki's investment-grade office rents contracted slightly by 1.8% HoH to JPY26,650 per tsubo. That said, a vast majority of investment-grade buildings saw r ents stay flat over the same period. Meanwhile, investment-grade vacancy loosened moderately by 3.3ppts HoH to 6.5%.

Despite some office buildings struggling with persistent vacancies, offices in Meieki appear to have garnered some interest among tenants from other submarkets, and some buildings have been able to keep filling floors. That said, a number of recently completed developments appear to be moving more slowly in comparison, and display notably elevated vacancies.

Fushimi and Marunouchi

Investment-grade office rents in both the Fushimi and Marunouchi submarkets remained unchanged for a second consecutive half-year, at JPY18,500 per tsubo and JPY16,200 per tsubo, respectively in 2H/2023. Meanwhile, investment-grade vacancy tightened in both submarkets, by 4.5ppts HoH in Fushimi to 11.7%, and by 0.6ppts HoH in Marunouchi to 6.4%.

Overall, both submarkets have been relatively stable and show signs of gradual improvement. That said, some work can still be done, with vacancies still visible in both submarkets, although the lack of new additions should give both submarkets some breathing room for further stabilisation. The upcoming Nagoya Shimizu Fukoku Life Building appears to be half pre-leased, which also bodes well for the market.

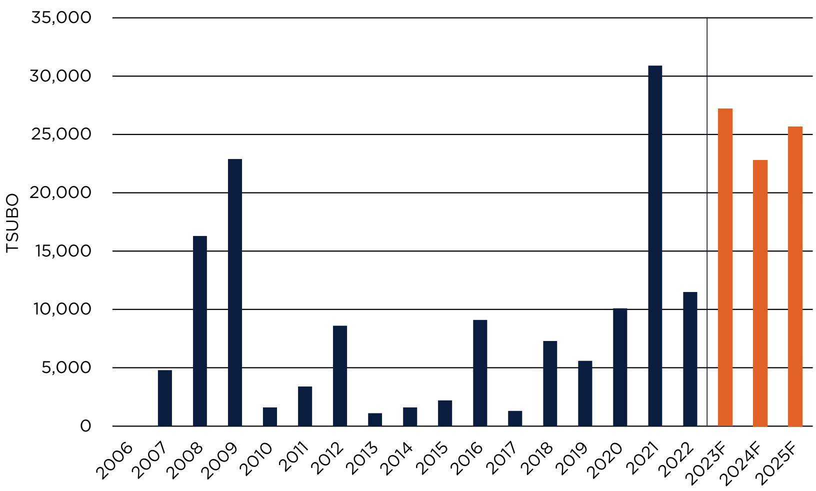
Outlook

Nagoya's investment-grade rents increased moderately, while investment-grade vacancy also rose over that past half-year. Although the market appears to have received the Chunichi Building well, some other newly completed offices are struggling to attract tenants, which has impacted market-wide vacancy, and does not bode particularly well for other incoming developments with bullish rents looking ahead.

Demand for office space does not appear to have enjoyed the same level of recovery as the wider economy in Nagoya. Indeed, while corporate profits have been strong in 2023, many large companies in Nagoya, which are often considered conservative, appear reluctant to relocate to more spacious offices, even if their current offices have become tight due to larger headcounts and greater office attendance. In addition, some hybrid work arrangements look to persist in many regional markets, and both factors have likely contributed to the current lukewarm sentiment in the Nagoya office market.

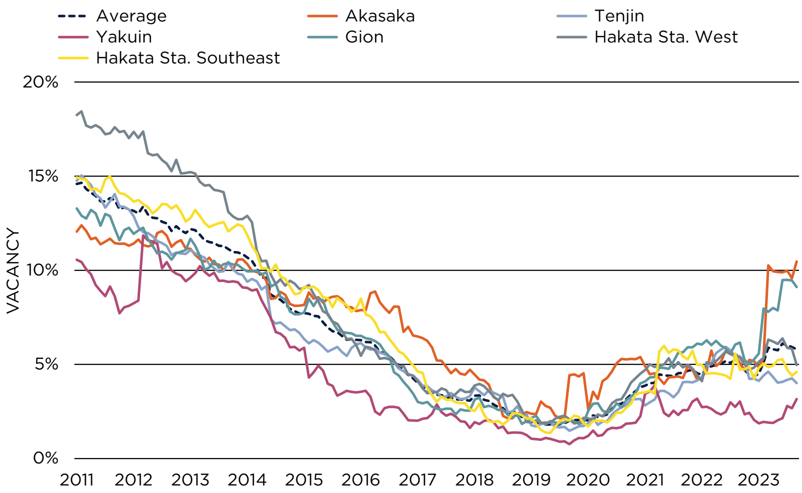
Nevertheless, while there are concerns surrounding the outlook of the Nagoya office market, there is still cause for optimism. Office attendance has been steadily recovering in Nagoya, which should gradually support further office demand, backed by broader economic recovery. Moreover, some future development plans are being reconsidered given the uncertainty in the market, constricting supply in coming years, and consequently giving more leeway to offices that have notable vacancy levels. Meanwhile, a major redevelopment project slated for completion in 2026 appears to have secured several tenants at a renewed top rental level of JPY30,000 in Sakae, which could symbolise newfound confidence in the submarket.

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



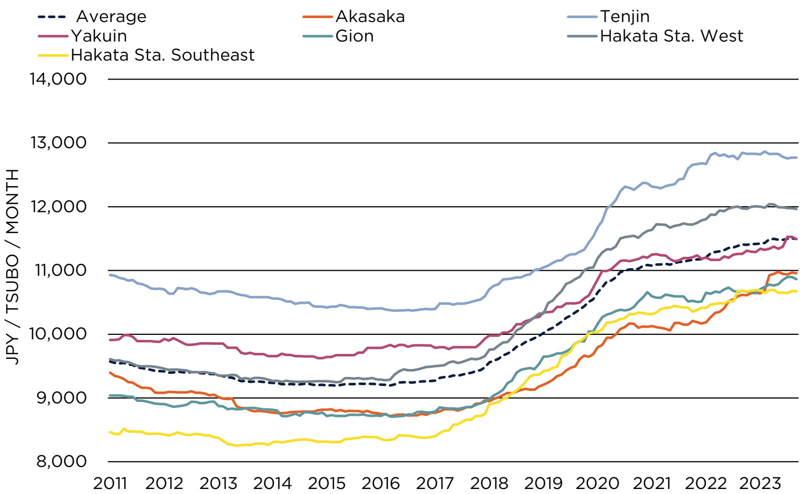
Source Sanko Estate,Savills Research & Consultancy

GRAPH 13 Vacancy Rate in Fukuoka City by Area, 2011 to Q3/2023



Source Miki Shoji, Savills Research & Consultancy

GRAPH 14: Average Rent in Fukuoka City by Area, 2011 to Q3/2023



Source Miki Shoji, Savills Research & Consultancy

FUKUOKA CITY

NRA

Over 25,000 tsubo of new NRA is forecast for completion in the Fukuoka office market in 2023. Although the situation in Fukuoka remains stable overall, some noticeable levels of vacancy have been observed in newly built offices, in addition to secondary vacancies that have materialised elsewhere. This may hint at some weakness in terms of overall tenant demand. For instance, Fukuoka Daimyo Garden City has struggled with securing tenants since its completion, while a handful of newly completed properties arrived to the market with elevated levels of vacancy. However, the large-scale rebound of inbound tourist numbers and the continued recovery of the Fukuoka economy should provide some comfort for observers.

Looking ahead, office supply is forecast to be similarly large in 2024 and 2025 – over 20,000 tsubo of NRA in both years. The symbolic One Fukuoka Building, set for completion in December 2024, will feature around 14,000 tsubo of office space, and will be a major addition in the Tenjin area. Overall, a majority of upcoming office developments will be concentrated in the Tenjin and Hakata submarkets, and the large influx of new supply may cause some temporary fluctuations upon completion, especially given that many of these new developments will aim for high price points of around JPY30,000 per tsubo.

Vacancy

Investment-grade vacancy tightened over the past half-year by 1.0ppts, but remains relatively elevated at 5.1%. This trend stems from a combination of small-scale reductions in vacancy among a many older properties, a number of which have carried out slight rental revisions, likely in order to remain attractive to tenants, and the encouraging absorption of newly completed properties over the last half-year that arrived to the market with high levels of vacancy. Overall, a majority of offices in the Fukuoka market appear to be performing well.

The all-grade market saw average vacancy rates fall by 0.1ppt HoH to 5.8%. Some minor fluctuations were observed across Fukuoka city, but changes were nominal overall. The Hakata and Tenjin submarkets performed relatively well over the past half-year, with vacancy tightening by 1.3ppts and 0.3 ppts in the Hakata Station West and Southeast submarkets, respectively, and decreasing by 0.6ppts in Tenjin. However, average all-grade vacancy remains elevated in the Akasaka

TABLE 3: Fukuoka Investment-grade Offices

	2H/2023	HOH	YOY
Rent	19,000	-1.2%	-0.5%
Vacancy	5.1%	-1.0ppts	+2.9ppts
Top Rent	30,000	0	0

Source Savills Research & Consultancy

submarket at 10.5%, which stems mainly from Fukuoka Daimyo Garden City.

Rent

In 2H/2023, investment-grade rents in Fukuoka decreased moderately by 1.2% over the past half-year, and currently hover around the JPY19,000 per tsubo level. Several older properties located in slightly remote areas carried out rental revisions, even despite having low levels of vacancy, likely in order to prevent existing tenants from looking to relocate.

Meanwhile, all-grade rents remained flat HoH at JPY11,500 per tsubo, which are record levels. Although the completion of large-scale modern office space in central submarkets as part of the Hakata Connected and Tenjin Big Bang projects should contribute to noticeable rental growth over the coming years, lukewarm demand at high rental levels may convince building owners to consider further rental revisions in order to secure requisite tenants sooner.

Hakata

Rents of investment-grade buildings in Hakata contracted by 0.8% HoH to JPY20,400 per tsubo. Meanwhile, investment-grade vacancy tightened moderately to 1.7% over the past half-year, which demonstrates the level of improvement taking place within the submarket. In addition, few projects of major scale are scheduled for completion in 2024, meaning that this stability will likely continue in the submarket for the time being.

In the longer term, the Hakata Connected project will feature a handful of major redevelopment projects until 2028 that look to fundamentally reshape the landscape of the Hakata Station area. This project will include the redevelopment of Hakata Ekimae-dori, and notably the Hakata Station Aerial City Project, a 12F mixed-use office and hotel development above Hakata Station. This initiative aims to improve the image of the Hakata area as a business and entertainment hub and encourage businesses to establish themselves in the submarket.

Tenjin

Similar to the Hakata submarket, investment-grade vacancy tightened notably by 4.2ppts HoH to 11.7%. However, investment-grade rents fell by a greater margin at 2.5% HoH to JPY21,100 per tsubo. Indeed, a number older properties in the submarket revised their rents, likely in order to compete with the upcoming supply of modern properties in the submarket.

Although Fukuoka Daimyo Garden City still exhibits elevated levels of vacancy, definite progress has been made over the past half-year, which should be a point of optimism moving forward. Additionally, there were no new additions in Tenjin in the latter half of 2023, which should provide properties in the submarket some more breathing room to absorb existing vacancies.

Like Hakata, the Tenjin submarket is set to see an uptick in development activity beyond 2024. This will involve the reconstruction of several large mixed-use office buildings and the overall improvement of the area surrounding Tenjin Station, and should become a major pull for potential tenants to the area going forward.

Outlook

The situation in Fukuoka's office market was mixed in 2H/2023, and appears to be searching for a stable equilibrium. Looking at respective submarkets, new developments in Tenjin appear to proceed, and growing landlord flexibility in terms of rents should ensure that floor space gets filled. Meanwhile, attention will gravitate toward Hakata with more development plans in the pipeline. Indeed, the Hakata area is well positioned to welcome new office tenants and residents, given its convenient public transport connections and its growing entertainment and dining options.

Overall, the Fukuoka office market looks to remain largely stable for the meantime. That said, the relatively large amount of new supply will likely contribute to increments in both average rents and vacancy moving forward. In addition, the US$8 billion development of chip-making facilities in other regions in Kyushu led by TSMC will undoubtedly have a knock-on effect, generating further business opportunities and investment in Fukuoka city.

SENDAI CITY

Supply and Demand

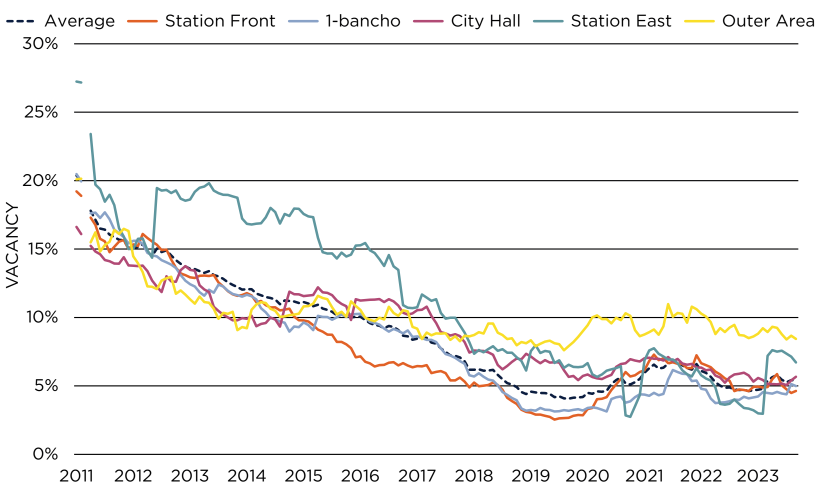
Roughly 15,000 tsubo of new office supply is slated for completion in Sendai in 2023, which is by far the largest amount since 2011. The most notable completion was the Yodobashi Sendai Daiichi Building in the Station East submarket, which appears to have arrived to the market with a large amount of vacancy. Nonetheless, vacancy and rental rates remain relatively stable in Sendai overall. Furthermore, forecasts indicate that only 4,000 tsubo of new NRA will be completed in 2024, which should provide more breathing room to absorb the recent large supply.

Looking forward, the Urbannet Sendai-Chuo Building in the prime Station Front submarket is scheduled for completion in November 2023, delivering over 7,000 tsubo of NRA to the market. Nevertheless, the situation appears stable for the meantime, with limited available stocks in the market.

Vacancy

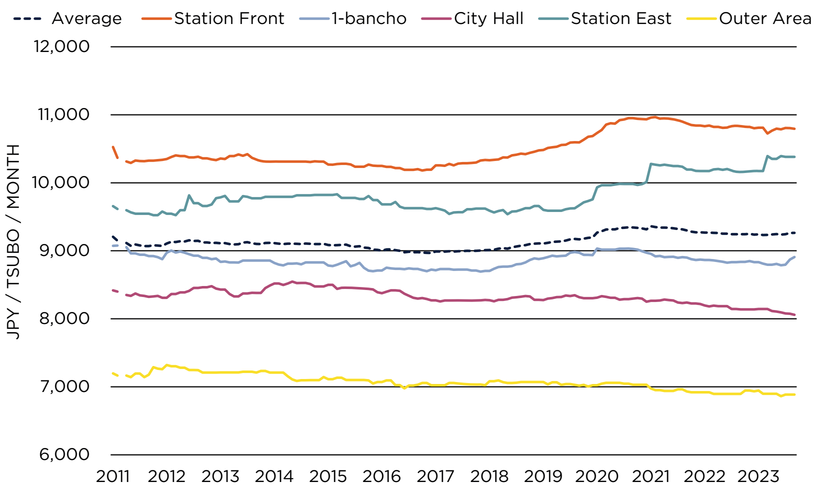
The all-grade vacancy rate in Sendai held steady HoH, remaining at 5.4% in Q3/2023. While vacancy rates remain over 1ppt higher than the pre-pandemic lows of 2019, the overall outlook for vacancy in Sendai appears optimistic, considering the substantial new supply in 2023.

GRAPH 15: Vacancy Rate in Sendai City by Area, 2011 to Q3/2023



Source Miki Shoji, Savills Research & Consultancy

GRAPH 16: Average Rent in Sendai City by Area, 2011 to Q3/2023



Source Miki Shoji, Savills Research & Consultancy

Sendai's constituent submarkets witnessed diverging trends over the past half-year. The Station Front submarket saw a slight dip of 0.3ppts HoH, with new supply being absorbed with limited issues.

The Outer Area and Station East submarkets tightened by 0.5ppts HoH each to 8.4% and 6.7%, respectively, but retain the highest vacancy levels across the Sendai market. Leasing demand appears to be firm in the Outer Area submarket, where many existing tenants have decided to expand their office footprints. On the other hand, while improving slightly over the past half-year, vacancy in the Station East submarket remains notably higher than a year ago due to the new addition.

Meanwhile, the 1-bancho and City Hall submarkets each saw increments of 0.5ppts HoH, reportedly due to new supply as well as tenant relocations. Going forward, some secondary vacancy might be observed with the large new addition in 2023.

Rent

Average all-grade office rents saw a slight increase of 0.3% HoH to JPY9,300 per tsubo in Sendai.

The most expensive submarkets experienced diverging rental performances, with rents in the Station Front submarket increasing by 0.7% to JPY10,800, while the Station East submarket contracted by 0.1% to JPY10,400. The Station Front submarket is likely to see an uptick in average rents upon the completion of new supply.

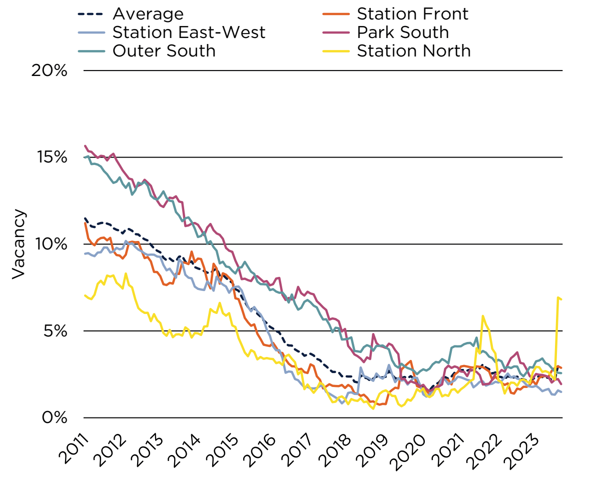
Meanwhile, the Outer Area submarket, known for its affordability, experienced a marginal decline of 0.2% HoH to JPY6,900 per tsubo. New supply is forecast to be limited for the meantime and hence, rental rates are expected to remain relatively stable for the time being.

Outlook

The office market in Sendai has demonstrated resilience, with rents and vacancies experiencing minimal changes over the past half-year. Overall, the absorption of current stock appears to be going well, despite the large new addition, although the completion of the Urbannet Sendai-Chuo Building may cause some fluctuations in the market.

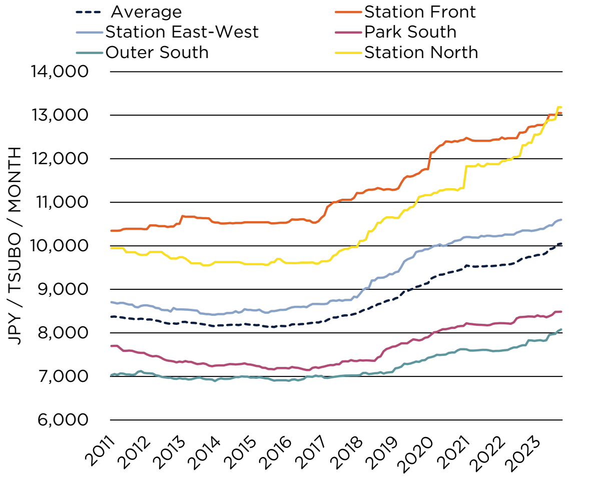
The Sendai office market faces a few hurdles going forward. Firstly, more companies in Sendai appear to be adopting flexible work policies, and some have downsized office space as a result. Moreover, office expansions may slow as the economy of Sendai has not fully recovered from the effects of the pandemic. That said, limited new supply after 2024 should keep the market tight and aid further stabilisation.

GRAPH 17: Vacancy Rate in Sapporo City by Area, 2011 to Q3/2023



Source Miki Shoji, Savills Research & Consultancy

GRAPH 18: Average Rent in Sapporo City by Area, 2011 to Q3/2023



Source Miki Shoji, Savills Research & Consultancy

SAPPORO CITY

Supply and Demand

10,000 tsubo of new supply arrived to the market in Sapporo in 2023 - the largest influx since 2007. The market has been very tight given the recent limited supply. The much-anticipated newly added buildings to the market appear to have been met with mixed reception over the past half-year. D-LIFE PLACE Sapporo, added to the Station Front submarket in May 2023, is almost fully occupied. On the other hand, The Link Sapporo in the Station North submarket which was completed in August 2023 appears to have high levels of vacancy.

2024 and 2025 will also be significant years for Sapporo, with approximately 10,000 tsubo of NRA forecast. Sosei Cross is scheduled to deliver approximately 2,500 tsubo of new office space in May 2024. Overall, despite the lukewarm performance of The Link Sapporo, demand for office spaces remains strong, which is a good sign for the market.

Vacancy

All-grade vacancy in Sapporo loosened slightly by 0.5ppts HoH to 2.9%. Vacancy levels in Sapporo remain tight overall, and are lower than the other surveyed cities by a considerable margin.

At the submarket level, there were moderate disparities in terms of vacancy. The Station North submarket witnessed the largest increase of 4.2ppts, reaching 6.8%, primarily driven by the completion of The Link Sapporo, which came to the market largely vacant.

Meanwhile, the Station Front submarket, which has seen an increase of 0.5ppts to 2.9%, also welcomed a new office building, D-LIFE PLACE Sapporo, which appears to have come to the market close to fully leased. That said, reports of some companies downsizing, on top of secondary vacancies in the area, contributed to the submarket's uptick in vacancy. On the other hand, vacancy levels in the Outer South submarket tightened by 0.9ppts to 2.6%, likely bolstered by the limited amount of new supply in the submarket.

Rent

The rental growth observed in recent years has continued in Sapporo, with average rents exceeding the JPY10,000 per tsubo level for the first time. All submarkets experienced rental increments, with average rents climbing by 2.5% HoH to JPY10,050 per tsubo.

The Station North submarket experienced the largest rental increment at 3.6% HoH to JPY13,200 per tsubo, slightly overtaking the Station Front as the most expensive submarket in Sapporo. The arrival of The Link Sapporo pushed average rents in the submarket upwards, and the completion of T-PLUS Sapporo in December 2023 should also contribute to some further rental growth. However, with many tenants downsizing their office footprints, in addition to the upcoming influx of new office supply over the next few years, landlords will likely be discouraged from being too bullish in increasing office rents.

Outlook

A majority of Sapporo's constituent submarkets have exhibited stable growth. However, the Station North submarket appears to have hit a road bump, and the absorption of the relatively expensive new supply may require more time, which will likely contribute to elevated levels of vacancy at least in the short term.

Overall, the Sapporo office market has demonstrated strong performance and should continue to do so moving forward. That said, the combination of significant new office supply in 2024 and 2025, and lukewarm demand among previously prominent call centres and IT firms may disrupt the market. From a medium-term perspective, new demand is also likely to be generated by the emerging chip making industry.

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