Japan - December 2024

SPOTLIGHT

Savills Research

Regional Japanese Office Markets

savills

Elevated office supply in 2024 received well, raising prospects

Summary

- Investment-grade offices have seen sound rental growth, rising half-year-on-half-year (HoH) in Osaka, Nagoya, and Fukuoka. Vacancy also saw some improvements, falling in all markets.
- The all-grade office market performed well in 2H/2024, with rental growth experienced in all regional markets, as well as vacancy decreasing moderately in all markets aside from Sapporo.
- Grade A office cap rates stayed flat over the past half-year, but tightened slightly in Nagoya, Sendai, and Sapporo on an annual basis. Overall, cap rates remain relatively tight across all regional submarkets.
- Overall investment volumes as of Q3/2024 lag those of the same period in 2023 by nearly 20%. Nevertheless, the appetite for office space remains firm, with a 15% increase in office investments over the same period.
- Osaka, Fukuoka, and Sapporo have welcomed elevated levels of new office supply in 2024. Strong demand for modern office space in prime areas has contributed to sound absorption with limited issues.
- New supply in 2025 will be moderate overall, which should cause minimal fluctuation in the market.
- Heightened construction costs and labour shortages have caused some delays to new office developments, which should limit incoming supply, and help to stabilise the market further.

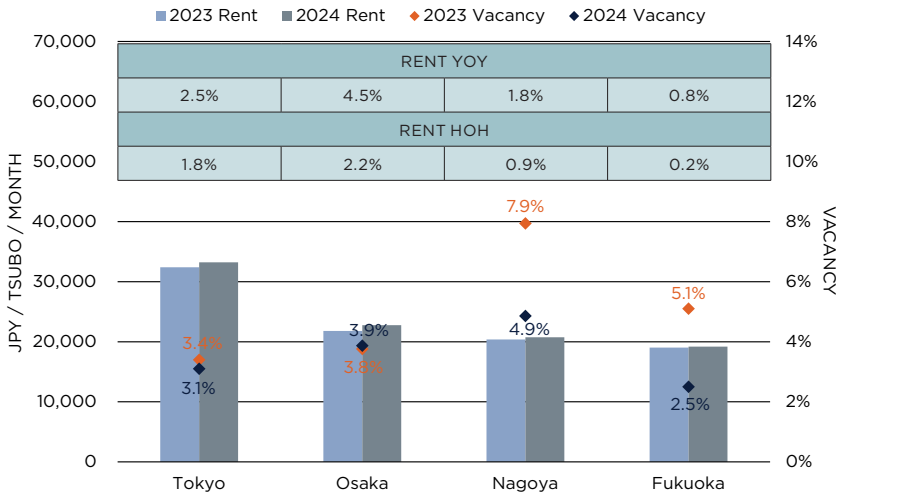
OVERVIEW

Over the past half-year, Japan's regional office markets have continued to follow a positive trajectory. Corporate performance has been impressive, with corporate profits in Q2/2024 having grown by 13.2% YoY, and are likely to continue to fare well given the improvements to domestic demand. Positive business sentiment should contribute to the further growth of Japan's regional office markets.

Given this positive situation, many companies are looking to scale up business operations and hire more staff. The state of the office market with some available stocks following the pandemic has provided tenants with the ideal environment to expand their office footprints and relocate to more convenient and prime locations. Demand has been particularly strong for modern properties that better enable communication and support employee wellbeing, which should help to attract and retain workers.

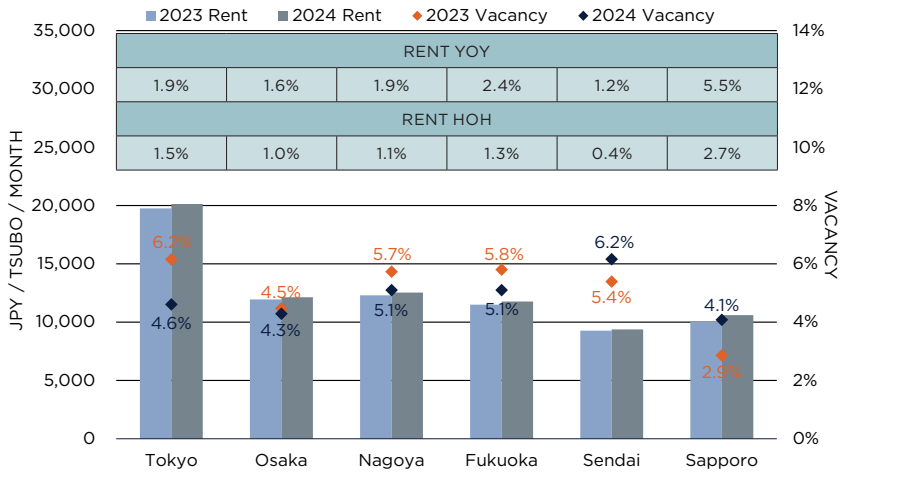
As such, although office completions in 2024 have been elevated in a majority of Japan's regional office markets, the general response has been largely positive, with minimal fluctuations observed in the office leasing market. Many new projects are mixed-use and

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



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

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



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

provide quality amenities, and are highly sought after, raising prospects.

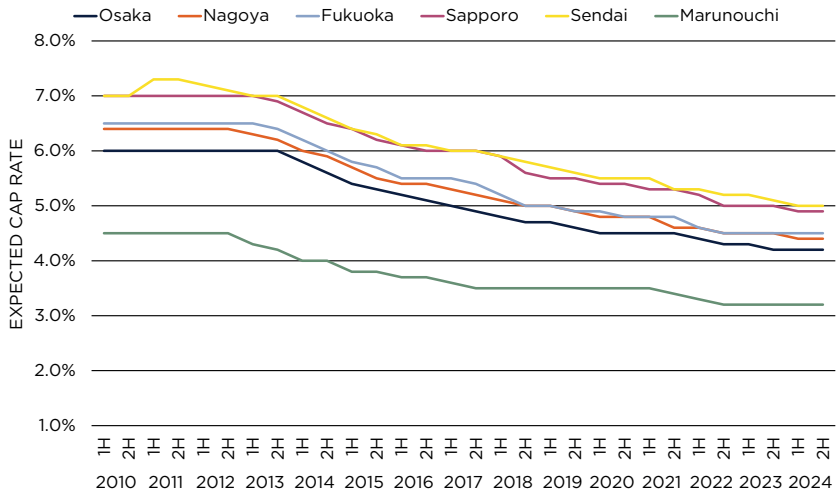
Osaka has been under the spotlight in 2024, with the completion of an extremely large 90,000 tsubo of office space. The iconic 35,000 tsubo GRAND GREEN OSAKA development in Umeda set a new bar for mixed-use office projects and urban redevelopment.

This sentiment is echoed elsewhere. Fukuoka welcomed a handful of major completions as part of the Hakata Connected and Tenjin Big Bang projects. In Sapporo, where supply has been relatively elevated for consecutive years, the sound appetite for modern office space has ensured that fluctuations are minimal, and that vacancy rates remain at manageable levels.

On the other hand, both Nagoya and Sendai have experienced a quiet year in terms of new office supply. In Nagoya, some moderately large offices were completed over the past half-year, and are already largely occupied. Meanwhile, in Sendai, only a few new completions were recorded at the start of 2024, which appear to have fared well overall.

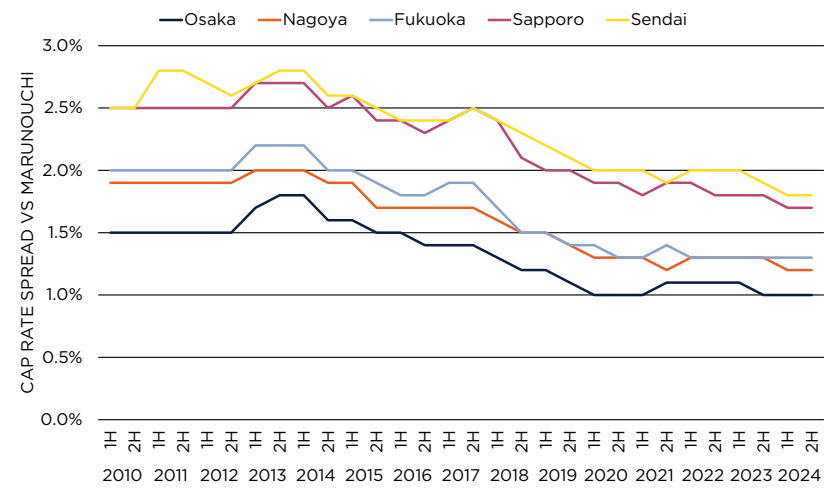
Positive business sentiment and strong hiring needs continue to support office demand. The decrease in vacancy rates due to corporate expansion led to a reduction in availability, creating a scarcity and accelerating the absorption of vacant space. Despite the notable influx of new office space in 2024, regional markets responded well, ensuring only limited fluctuations. New supply will be limited in 2025, which bodes well for market stability moving forward.

GRAPH 3: Expected Cap Rates for Grade A Offices, 2010 to 2H/2024



Source Japan Real Estate Institute, Savills Research & Consultancy

GRAPH 4: Expected Cap Rate Spreads (vs Marunouchi), 2010 to 2H/2024



Source Japan Real Estate Institute, Savills Research & Consultancy

Regional investment-grade office markets have exhibited strong recovery over the past half-year. Indeed, Osaka, Nagoya, and Fukuoka all recorded rental growth of 2.2% HoH, 0.9% HoH, and 0.2% HoH, respectively. Meanwhile, investment-grade vacancy in Fukuoka, Nagoya, and Osaka decreased moderately by 1.4ppts HoH, 0.8ppts HoH, and by 0.1ppts HoH, respectively.

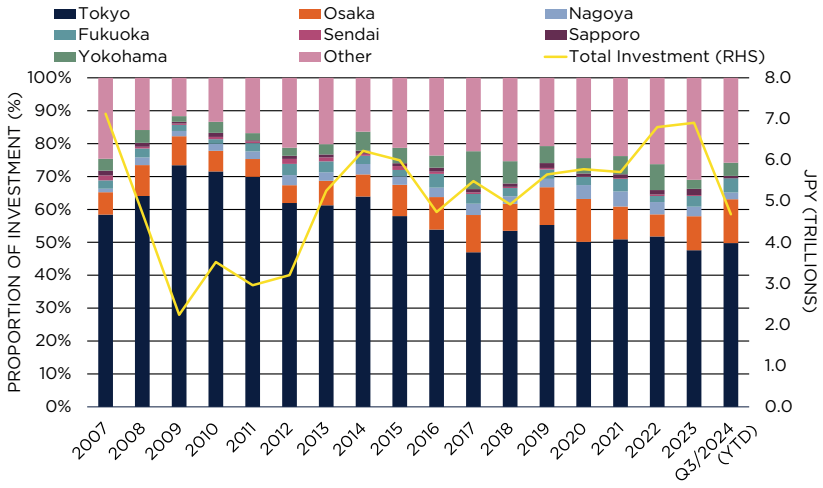
All-grade office markets also remained on a favourable trajectory over the past half-year, with all regional markets enjoying half-yearly rental growth. Sapporo again saw the largest rental increment of 2.7% HoH. Rental growth was moderate in other markets. The vacancy situation was similarly positive, with all markets aside from Sapporo seeing vacancy rates fall. That said, moderate loosening in Sapporo appears to have been triggered simply by the large influx of office supply, and should be temporary as strong demand from tenants helps to deal with existing vacancies.

REGIONAL INVESTMENT

According to the bi-annual investor survey conducted by the Japan Real Estate Institute in October 2024, expected cap rates in all regional markets remained flat over the past half-year but Nagoya, Sendai, and Sapporo tightened by 10 basis points (bps) on an annual basis. Prices remain elevated across most real estate sectors in Japan, and this cap rate compression is a demonstration of renewed interest in Japanese real estate among investors.

According to transaction data from MSCI, total investment volume nationwide as of Q3/2024 was around 20% lower than the

GRAPH 5: Investment Volumes by Area for All Asset Types, 2007 to Q3/2024 (YTD)



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

same period in 2023. Indeed, some investors are currently in a wait and see mode given the potential for gradual interest rates increases in Japan. However, office transactions in 2024 have exceeded those of the previous year by around 15%, demonstrating that interest is still firm in the Japanese office market, given the sustained recovery of the sector from the pandemic-induced slump. Moreover, the 2024 figures are still preliminary and are expected to increase as more transactions are confirmed.

A handful of large office transactions took place in Japan's regional markets during the second half of 2024. For instance, a domestic consortium of Chiba Bank, Fuyo General Lease, Daiei Real Estate & Development, and other players acquired World Business Garden in Chiba for a reported JPY68.0 billion, which was the largest reported office transaction outside of Tokyo in 2024.

Elsewhere, Kanden Realty & Development reportedly acquired the former Toyobo Headquarters building in Osaka from Gaw Capital for JPY30.1 billion, while KKR-sponsored Japan Metropolitan Fund REIT acquired JMF-Bldg. Osaka Fukushima 02 for JPY14.6 billion from Mizuho Leasing Company.

Cross-border office investment appears to have made some progress over the past half-year, with some foreign investors having turned their attention back. Furthermore, interest should return more as the office leasing market regains its vigour. Indeed, many prime office properties have been performing well, and some owners may choose to sell their recently filled assets, creating opportunities for investors with conviction.

OUTLOOK

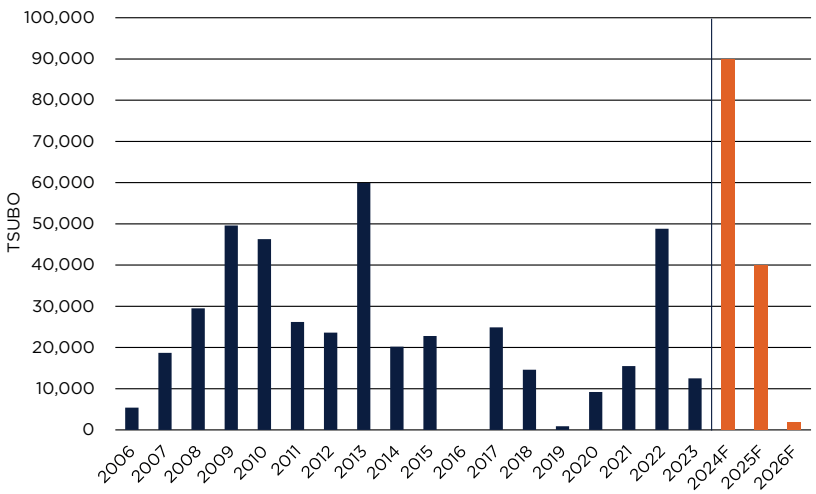
Sound improvements have continued in Japan's regional office markets in the second half of 2024. This comes against the backdrop of moderate economic growth, strong corporate performance, and labour shortages. Indeed, many firms have been keen to expand on their business operations and headcounts, and many companies have expanded their offices in modern properties in prime locations. As such, office leasing markets have been strong overall.

New office supply in 2024 has been elevated, but has nonetheless been received well overall. Tenants have needed to move quickly to lease modern office space with superior amenities, resulting in strong leasing performance among many new properties despite the higher rents. Looking ahead, new office supply in 2025 is forecast to be moderate by comparison in most markets, which should provide breathing room for the absorption of existing vacant space and further improvements in respective office markets.

Meanwhile, the heightened cost of construction will likely constrain office supply moving forward. This should be a silver lining for office leasing markets, by spacing out new office completions and reducing the impact of new supply on respective vacancy rates.

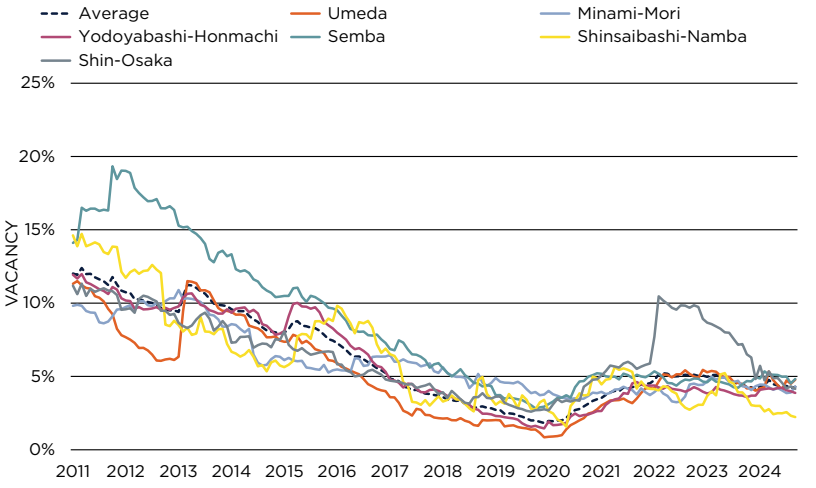
Overall, the performance of regional office markets has continued to improve in 2024. Modern office space in prime locations is highly sought after given the need to attract workers, and should ensure the smooth absorption of the incoming moderate office supply in 2025 with minimal fluctuations. As such, vacancy should continue to fall, with sound prospects of further moderate rental growth.

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



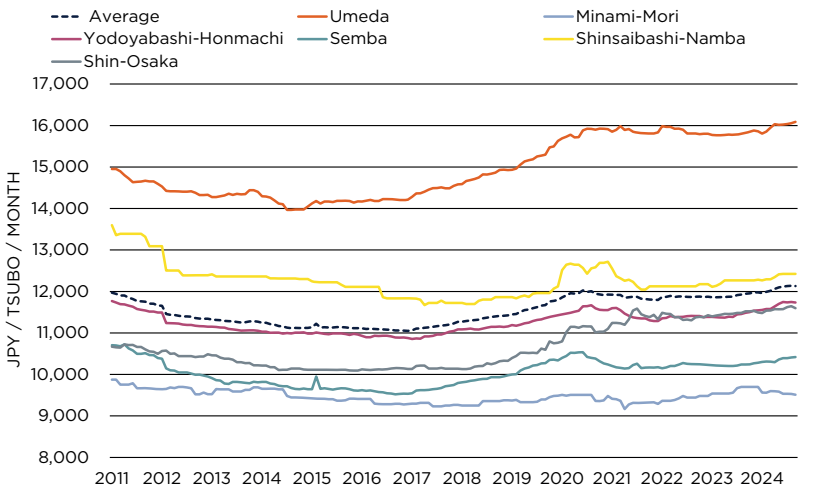
Source Sanko Estate, Savills Research & Consultancy

GRAPH 7: Vacancy Rate in Osaka City by Area, 2011 to Q3/2024



Source Miki Shoji, Savills Research & Consultancy

GRAPH 8: Average Rent in Osaka City by Area, 2011 to Q3/2024



Source Miki Shoji, Savills Research & Consultancy

OSAKA CITY

Net Rentable Area (NRA)

Osaka witnessed the influx of a record new office supply of around 90,000 tsubo NRA in 2024, the largest in three decades. Despite initial concerns, the market largely responded well to the new supply, with most additions making sound progress in being absorbed, given the strong demand for offices with premium amenities.

INOGATE OSAKA and PRIME GATE UMEDA, completed in the second half of 2024 with a combined total of 10,000 tsubo NRA, have been met with strong demand, and nearly half of the available space is already occupied by tenants.

Elsewhere, GRAND GREEN OSAKA will deliver approximately 35,000 tsubo of NRA by the year end. The colossal project will establish a new benchmark for mixed-use office developments with its expansive green spaces, eco-friendly design, and diverse amenities, such as exclusive dining, fitness centres, and sauna spaces. Despite the high rental level, the development has seen strong tenant demand.

Moreover, new supply in 2025 will be less than half of that of 2024 at over 40,000 tsubo, while only one moderate office building is forecast for completion so far in 2026, which should provide ample breathing room to absorb any existing vacant space and help to stabilise the market.

Vacancy

Despite the large influx of new office supply, investment-grade vacancy rates fell by 0.1ppt HoH to 3.9% in 2H/2024. Meanwhile, all-grade office vacancy rates tightened by 0.5ppts HoH to 4.3%. The Shin-Osaka submarket witnessed the largest tightening of 1.2ppts HoH. Minami-Mori experienced a marginal loosening of 0.1 ppts HoH, while all other submarkets experienced moderate vacancy tightening over the past half-year.

Positive business sentiment has supported strong demand for office space among tenants. Indeed, a survey on office movement trends by Biz Life Agent in Q3/2024 shows that nearly 70% of relocating tenants over the quarter either expanded on their existing office footprints or changed offices in order to improve the quality of their facilities. This confidence should bode well for the absorption of existing vacant space and help to improve the stability of the Osaka office leasing market moving forward.

Rent

Rents among investment-grade offices increased by 2.2% HoH to JPY22,800 per

TABLE 1: Osaka Investment-grade Offices

	2H/2024	HOH	YOY
Rent	22,800	2.2%	4.5%
Vacancy	3.9%	-0.1ppts	+0.1ppts
Top Rent	38,000	-4,000	0

Source Savills Research & Consultancy

tsubo in 2H/2024. Indeed, a few premium new additions to the market have rents in excess of JPY35,000 per tsubo, which have made a noticeable contribution to increasing the overall rental level. Despite the large amount of new supply having arrived to the market in 2024, the favourable appetite for premium offices has been confirmed.

All-grade rents increased by 1.0% HoH to JPY12,100 per tsubo. Yodoyabashi-Honmachi submarket experienced the largest increase of 1.4% HoH. Minami-Mori witnessed rental decline of 0.9% HoH, while all other submarkets experienced rental growth over the past half-year.

Umeda

Given the arrival of some premium offices in the submarket, rents for investment-grade offices in Umeda increased significantly by 4.1% HoH in 2H/2024, following the strong rental growth seen in the previous half-year. On the other hand, some of these properties still have some way to go before being fully absorbed. As such, investment-grade vacancy increased by 1.7ppts HoH to 6.4%. Nevertheless, this should be temporary, and the current mood in the market hints at uneventful absorption going forward.

Umeda captured the lion's share of the recent new supply with the completion of GRAND GREEN OSAKA and INOGATE OSAKA, which have transformed the landscape of the Osaka station area and further improved the stock of premium office space. These new developments are set to fetch premium rents in the mid-to-high JPY30,000 per tsubo range, which should continue to push the submarket average rental level upwards. Overall, Umeda is in a strong position, demonstrated by the encouraging progress of the new supply.

Yodoyabashi-Honmachi

Average rents for investment-grade offices in the Yodoyabashi-Honmachi submarket remained flat HoH at JPY23,300 per tsubo in 2H/2024, while vacancy also remained flat at 3.7% over the same period. The new supply from the first half of the year was received well, and the submarket received no new supply over the remainder of the year and many potential tenants have likely been drawn to premium new offices additions in nearby submarkets.

New supply in early 2024 has been largely absorbed with limited issue, and new completions in the Yodoyabashi-Honmachi submarket will be limited in the second half of 2024. This should bolster the market, allowing for the further absorption of existing vacancies before the forecast injection of a substantial 13,000 tsubo of NRA in the first half of 2025, primarily contributed by the YODOYABASHI Station One.

Shin-Osaka

Prospects are becoming brighter in the Shin-Osaka submarket, with investment-grade rents increasing by 3.4% HoH to JPY19,300 per tsubo, while investment grade vacancy continues to improve, decreasing by 1.1ppts HoH to 1.3%.

No new completions were observed in the submarket over the past half-year, providing room for further absorption of existing office space. This should help Shin-Osaka to bridge the gap and reach vacancy and rental levels comparable to other Osaka submarkets. Moreover, no upcoming completions are in the pipeline, which should contribute to sustained improvements moving forward.

Outlook

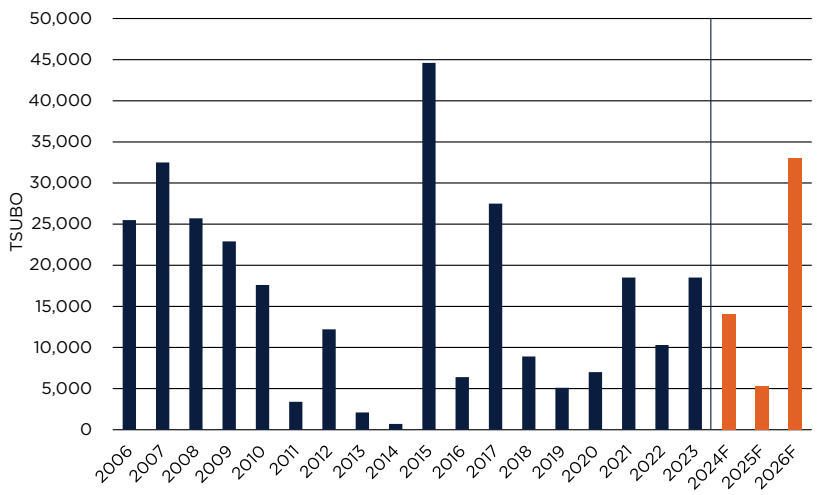
Overall, the record new supply in Osaka in 2024 has been received well and the market is in an encouraging position. New completions over the coming years will be moderate, which should usher in greater stability to the market moving forward.

The completion of GRAND GREEN OSAKA may be a gamechanger for the Umeda submarket. The large mixed-use development will transform the surrounding area, offering modern and diverse amenities to tenants and driving new demand overall, even at the high rental level.

Meanwhile, the wider economic prospects in Osaka are sound, which should support a strong office leasing market. The World Expo 2025, in addition to the development of the Integrated Resort, should further stimulate the economy of Osaka.

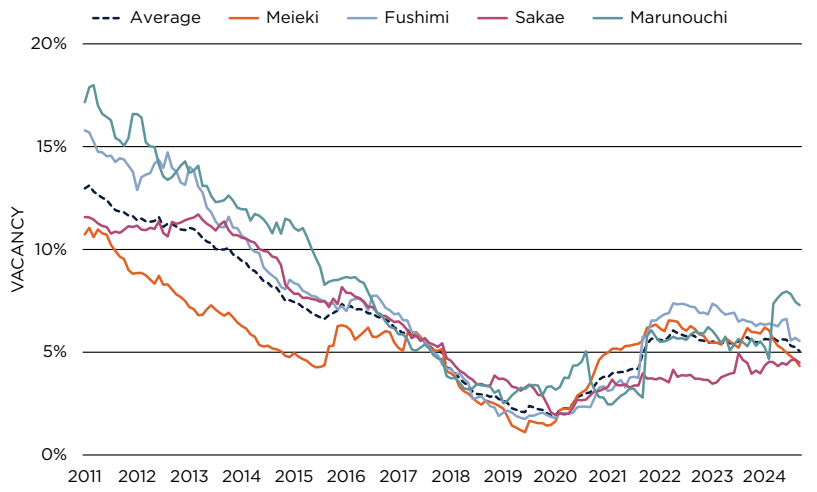
Overall, the situation is positive in the Osaka office market. While the influx of large supply may cause short-term disruptions, the moderate supply forecast over the coming years, in addition to Osaka's strong economic fundamentals, should support an optimistic outlook for the market.

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



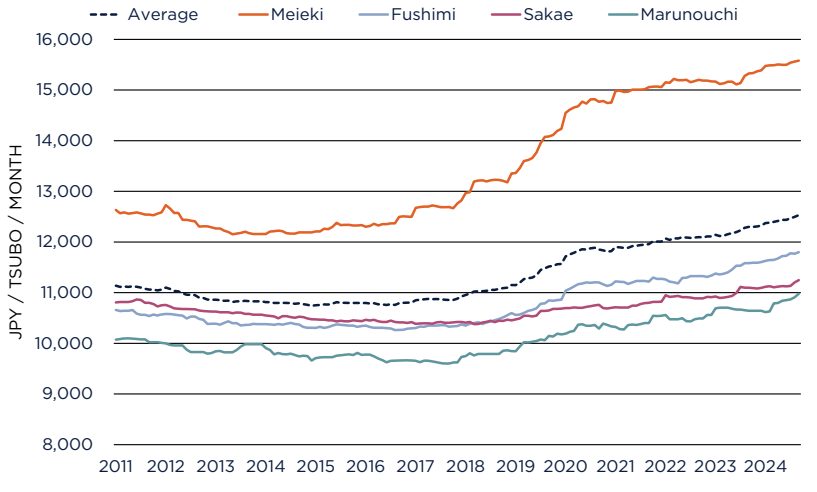
Source Sanko Estate, Savills Research & Consultancy

GRAPH 10: Vacancy Rate in Nagoya City by Area, 2011 to Q3/2024



Source Miki Shoji, Savills Research & Consultancy

GRAPH 11: Average Rent in Nagoya City by Area, 2011 to Q3/2024



Source Miki Shoji, Savills Research & Consultancy

NAGOYA CITY

NRA

New office supply in Nagoya in 2024 has been in line with 2023, with an influx of around 14,000 tsubo, and the most notable additions were the Nagoya Shimizu Fukoku Seimei Building and the 2nd Nagoya Sanco Building.

Tenant relocation activity has been more active in Nagoya, and these new additions have been received well by the market and are largely occupied, aided by popular amenities such as lounges. The strength of tenant demand can be reflected by the survey on office movement trends by Biz Life Agent in Q3/2024. It says that over 50% of respondents had relocated their office to either expand their office footprint or improve the location of their premises. The survey also outlines the desire for premium amenities, such as office lounges and meeting space, which bodes well for the absorption of incoming premium supply.

New office supply in 2025 will comprise just the Nagoya K Frontier Building with a moderate NRA of around 5,000 tsubo, which will provide breathing room for further improvements in the market. Although the large scheduled influx of new supply in 2026 of over 30,000 tsubo could potentially cause some fluctuations, particularly in Meieki and Sakae submarkets, strong corporate performance and appetite for modern and centrally positioned office space should ease many concerns.

Vacancy

Investment-grade office vacancy in Nagoya continued to fall by 0.8ppts HoH to 4.9% in 2H/2024. New additions in Nagoya have been largely filled in 2024, while many properties that previously struggled with vacancies have also made notable progress in securing tenants over the past half-year, which demonstrates the strength of recovery in the Nagoya market.

The average all-grade market vacancy in Nagoya decreased moderately by 0.6% HoH to 5.1%. The largest improvements were observed in Meieki submarket, where vacancy tightened by 1.3ppts HoH to 4.3%. Fushimi performed similarly well, tightening by 0.8ppts HoH to 5.6%. Marunouchi still appears to face some difficulties in absorbing available office space, and the average vacancy rate in the submarket remains at a relatively elevated level of 7.3%.

Rent

Investment-grade office rents in Nagoya increased by 0.9% HoH over consecutive half-years to JPY20,700 per tsubo. Several properties with low levels of vacancy appear

TABLE 2: Nagoya Investment-grade Offices

	2H/2024	HOH	YOY
Rent	20,700	0.9%	1.8%
Vacancy	4.9%	-0.8ppts	-3.0ppts
Top Rent	35,000+	0	0

Source Savills Research & Consultancy

to have increased their rents over the past half-year, demonstrating the strength of market demand.

Meanwhile, all-grade rental growth has been sound in 2024, with average Nagoya rents increasing by 1.1% HoH to JPY12,500 per tsubo in 2H/2024. Marunouchi recorded the largest half-yearly all-grade rental increment over consecutive periods, with rents increasing by 1.8% HoH to JPY11,000 per tsubo. Elsewhere, rents increased in both Fushimi and Sakae by 1.3% HoH to JPY11,800 per tsubo and JPY11,200 per tsubo, respectively, as well as in the most expensive submarket, Meieki, by 0.6% HoH to JPY15,600 per tsubo.

Meieki

Meieki's investment-grade office rents rebounded by 0.6% HoH to JPY26,800 per tsubo, while investment-grade vacancy tightened by 0.6ppts HoH to 4.2% in 2H/2024. Strong demand from tenants has supported a positive and stable situation in Meieki. Indeed, the 2nd Nagoya Sanco Building is already largely occupied, while the Meiji Yasuda Seimei Nagoya Ekimae Building, scheduled for completion in 2026 is already receiving firm interest from potential tenants.

Indeed, in the same Biz Life Agent survey, many responding tenants (29%) had relocated to Meieki, and as such comprised the largest overall volume of floorspace leased in Nagoya in Q3/2024.

Looking ahead, the redevelopment of Meieki, including upgrades to public transport and pedestrian access, should transform the area, which should attract tenants and generate new demand, driving further rental growth in the submarket.

Fushimi and Marunouchi

Investment-grade office rents increased by 2.7% HoH in the Marunouchi submarket to JPY17,100 per tsubo, while rents in Fushimi increased by 0.8% HoH to JPY18,700 per tsubo. Vacancy decreased in both Fushimi and Marunouchi, by 0.8ppts HoH and 1.4ppts HoH, respectively. Although Marunouchi still has a handful of offices with relatively elevated vacancy rates, with the submarket average at 8.1%, many office buildings have made noticeable progress over the past half-year, and should improve further as the market continues to recover as a whole.

New additions have been relatively elevated, with the completion of the Nagoya Shimizu Fukoku Seimei Building and the I-FOREST Nagoya Fushimi Building in early 2024 accounting for roughly half of the year's new office supply. The strength of demand for modern offices with quality amenities in the city centre helps to dampen temporary concerns about existing vacant space.

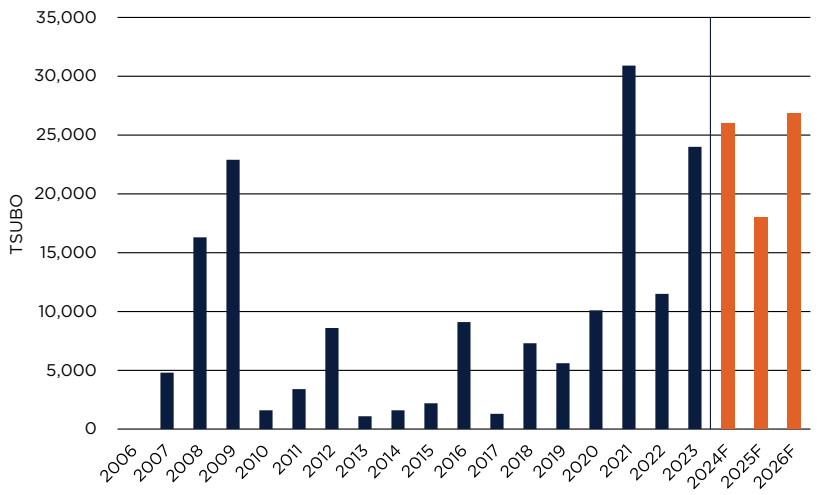
Outlook

The Nagoya office market has performed well in the second half of 2024, and tightened vacancy and moderate rental growth are a testament to this. Overall, corporate demand has remained strong, with many companies moving quickly to improve their office quality and locations while there are premium office options still available.

As such, a majority of new developments in 2024 have received firm interest and have been absorbed with limited issue, which has been aided by some incentives. In addition, given the background of labour shortages, the desire to expand business operations and headcounts has encouraged many tenants to seek more premium office options in more convenient locations to attract workers. Given the limited new supply forecast in 2025, these tight market conditions should continue for the meantime.

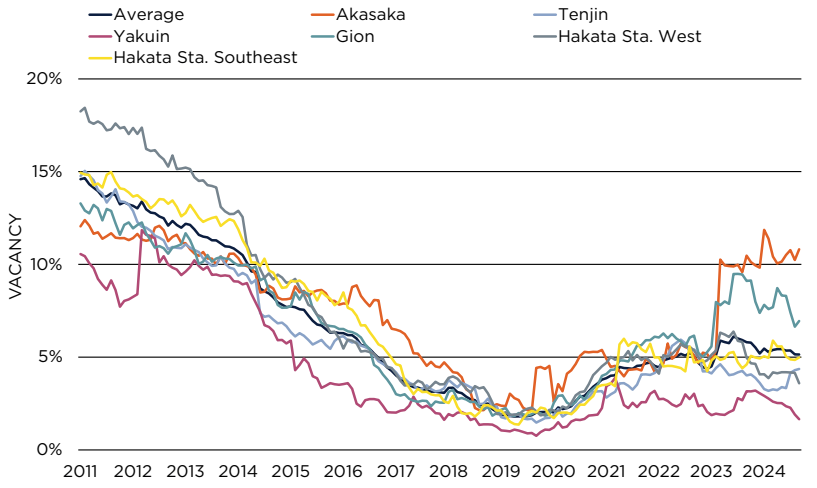
Over the coming decade, a series of redevelopment projects will transform the central areas of Nagoya. For instance, Sakae will welcome a few large mixed-use office developments in 2026, including the Landmark Nagoya Sakae, which is rumoured to have already secured several tenants, and should continue to polish the image of the submarket. Elsewhere, Meieki is set for major changes with the development of the Chuo Linear Shinkansen, although not in the near future.

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



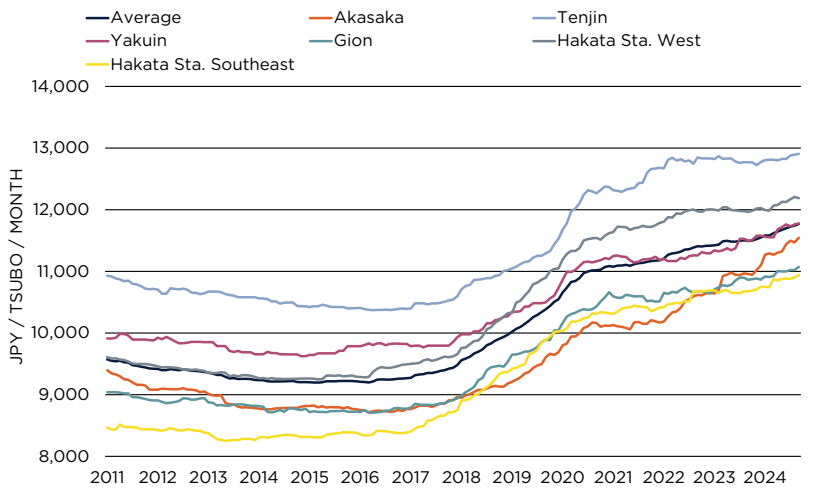
Source Sanko Estate, Savills Research & Consultancy

GRAPH 13: Vacancy Rate in Fukuoka City by Area, 2011 to Q3/2024



Source Miki Shoji, Savills Research & Consultancy

GRAPH 14: Average Rent in Fukuoka City by Area, 2011 to Q3/2024



Source Miki Shoji, Savills Research & Consultancy

FUKUOKA CITY

NRA

Over 25,000 tsubo of new office space arrived to the Fukuoka market in 2024, similar levels compared to the previous year. The highly anticipated largest addition, the ONE FUKUOKA BLDG., will contribute 14,000 tsubo of new office NRA by the year's end.

New supply in 2025 is projected to be lower than 2024, at 18,000 tsubo. Sumitomo Life Insurance and Fukuoka Jisho are redeveloping the Tenjin Sumitomo Life FJ Business Center as a large mixed-use office building, expected to feature around 7,000 tsubo of office space. While some temporary fluctuations are a possibility over the next two years given the elevated volume of incoming office supply, new completions are expected to generate new demand and strengthen the Fukuoka office market from a longer-term perspective.

Vacancy

Investment-grade vacancy continues to improve in Fukuoka, having fallen by 1.4ppts HoH to 2.5%. Many properties fully filled their floors over the past half-year, while most newly completed offices continue to make progress in attracting tenants. However, a few older properties saw some space returned by tenants over the past half-year, and many landlords may be concerned about competition from new premium units. Nevertheless, the situation is tight overall, given the strength of corporate performance and business sentiment.

Meanwhile, all-grade market average vacancy rates fell by 0.3ppts HoH to 5.1%, and performances across constituent submarkets were mixed. Yakuin and Hakata Station Southeast displayed the largest improvements, down 0.9ppts HoH. Conversely, vacancy increased in Tenjin by 1.1ppts HoH, while the Akasaka submarket continues to face difficulties, with all-grade vacancies remaining above 10%, partly exacerbated by the addition of 500 tsubo of new office space over the past half-year.

Rent

Investment-grade rents in Fukuoka saw some marginal uplift over the past half-year, and currently hover around JPY19,200 per tsubo. Although some newly completed properties have been able to increase rents, there appears to be some bifurcation in the market, with some older and less premium offices having to lower rents, likely in order to remain competitive.

Average all-grade office market rents increased moderately by 1.3% HoH to JPY11,800 per tsubo in Fukuoka, with all

TABLE 3: Fukuoka Investment-grade Offices

	2H/2024	HOH	YOY
Rent	19,200	0.2%	0.8%
Vacancy	2.5%	-1.4ppts	-2.6ppts
Top Rent	30,000	0	0

Source Savills Research & Consultancy

submarkets experiencing rental growth over the past half-year. New office developments as part of the Tenjin Big Bang project are expected to have premium rents, likely to drive up the average market rental level further.

Hakata

Rents of investment-grade offices in Hakata rose 1.0% HoH to JPY20,900 per tsubo. Investment-grade vacancy tightened by 0.7ppts HoH to 0.3%. The office market in Hakata overall continues to perform very well, with extremely tight vacancy, because of the strong demand for high quality office space in prime areas. Moreover, three large buildings around the station area have been closed for redevelopment, further limiting choices for those seeking office space.

The 3,500 tsubo Connect Square Hakata, completed in March 2024, has been received well by tenants, and is nearing full occupancy. Looking ahead, the Chuo Nittochi Hakata Ekimae Building is set to introduce 2,400 tsubo of NRA in mid 2025, and should perform well given robust tenant demand for high-quality office space in the area.

Tenjin

Tenjin has also improved, with investment-grade rents rising 0.9% HoH to JPY21,500 per tsubo, while vacancy tightened by 2.1ppts HoH to 5.7%. At the same time, vacancies are still noticeable in a few major developments, which is likely to have some impact on the absorption of future supply in the submarket.

2024 has been a busy year for completions in Tenjin, with a few major new office projects including the ONE FUKUOKA BLDG. and the Hulic Fukuoka Building. While there were concerns about demand for large premium offices with rents at JPY30,000 per tsubo, more than half of the ONE FUKUOKA BLDG. is already pre-leased, demonstrating some demand for high-quality office spaces. At the same time, the large amount of such supply in the pipeline could take longer to be pre-leased or filled. Nonetheless, overall, mid-term prospects are good in Tenjin, with the Tenjin Big Bang project set to enhance the overall office landscape of the submarket, generating new demand and encouraging further rental growth over the long term.

Outlook

The Fukuoka office market is currently characterised by the series of large-scale office development projects, and has continued to grow steadily over the past half-year. Office supply is forecast to remain high over the coming years, centered on several large-scale developments as part of the Tenjin Big Bang and Hakata Connected projects.

While the influx of large new office supply with premium rents may face potential challenges in securing tenants in the short term, modern office spaces equipped with amenities such as private booths and meeting rooms should have a positive impact on the overall supply-demand balance. In fact, many new offices with premium amenities have been received well in 2024.

Moreover, the Tenjin Big Bang and Hakata Connected projects are expected to have a broader positive impact on the area over the long term, delivering more high-quality office stock, which should generate new demand in central areas, and raise the prospect of further rental growth. At the same time, the two areas face different prospects. On the one hand, Hakata looks to be in good shape, with ongoing demolitions limiting the amount of high-quality office stock, and high construction costs potentially postponing some future office building plans in the area. On the other hand, Tenjin will see a large amount of office supply come to the market soon, on top of the new buildings that have been recently added, and it is uncertain whether demand is high enough to comfortably absorb this supply soon.

Elsewhere, the first JASM semiconductor facility (TSMC) in Kumamoto will begin mass production and shipments by the end of 2024, and is preparing to construct a second plant, slated to commence operations in 2027. The facilities are anticipated to have a JPY10+ trillion economic impact on the local economy over the next ten years, including Fukuoka.

SENDAI CITY

Supply and Demand

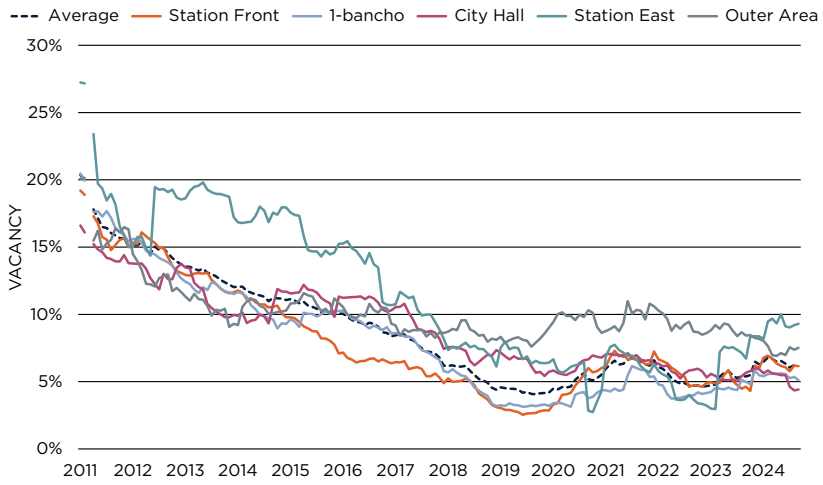
The Sendai market has experienced a relatively quiet year in terms of new supply in 2024, following the large influx of approximately 15,000 tsubo of NRA in 2023. A number of large additions came to the market at the start of 2024, including T-PLUS Sendai in the Station Front submarket which added around 2,500 tsubo of NRA, and the Sendai KS Building in the Station East submarket which added around 1,200 tsubo of NRA. Despite a few vacancies persisting in the market from the previous year, the new additions appear to have fared well overall.

In 2025, the most major office development will be the NANT Sendai Minamimachi in the Station Front submarket, which will add 2,500 tsubo of NRA to the market. Given the sound performance of the market, this moderate new addition should not have an impact on the market.

Vacancy

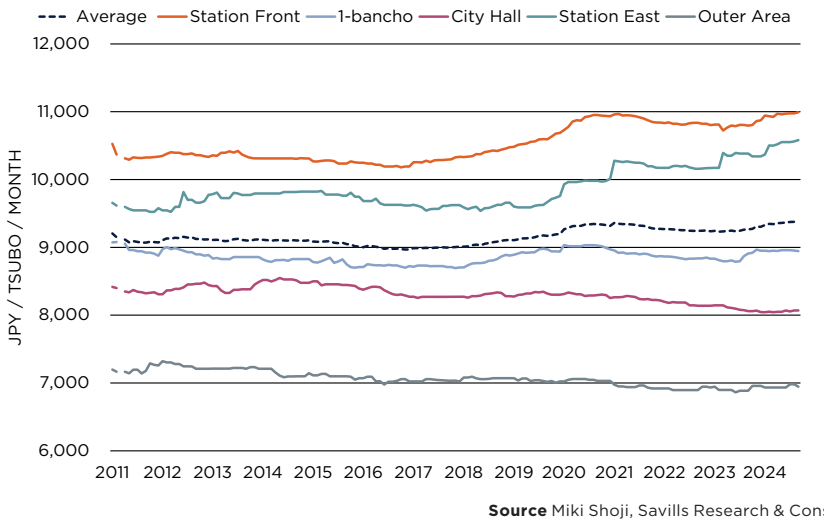
The all-grade vacancy rate in Sendai tightened by 0.5ppts HoH to 6.2%, with most submarkets experiencing moderate improvements. Although Sendai's average vacancy rate is the most elevated among the surveyed regional office markets, Sendai continues to make progress as corporate performance improves in the post-pandemic period.

GRAPH 15: Vacancy Rate in Sendai City by Area, 2011 to Q3/2024



Source Miki Shoji, Savills Research & Consultancy

GRAPH 16: Average Rent in Sendai City by Area, 2011 to Q3/2024



Source Miki Shoji, Savills Research & Consultancy

Vacancy rates in the City Hall submarket tightened by 1.2ppt HoH to 4.4%, the lowest figure among Sendai's constituent submarkets. Elsewhere, improvements were made in the Station Front and Station East submarkets, with vacancy rates tightening by 0.6ppts HoH and 0.4ppts HoH, respectively. However, given the addition of a few relatively large office developments, vacancy is relatively elevated in the submarkets around Sendai station, and further improvements are anticipated in the area.

Rent

Average all-grade office rents experienced moderate rental growth at 0.4% HoH to JPY9,400 per tsubo in 2H/2024. Rental growth was the strongest around the Sendai station area, with the Station East submarket recording half-yearly rental growth of 0.8%, and Station Front rents growing 0.6% on a half-yearly basis, and feature the highest rents on average by a considerable margin. Indeed, submarkets within close proximity to Sendai station have been the main beneficiaries of new supply in recent years, which continues to improve the landscape of the area, and raises the rental upside potential.

Elsewhere, average rents increased in the City Hall submarket by 0.3% HoH, as well as in the Outer Area submarket by 0.2% HoH. The 1-bancho submarket was the only one to experience a rental decline, albeit at a moderate 0.1% HoH. Overall, there is a high possibility of sustained rental growth in the Sendai market in 2025, given the city's sound fundamentals and the improvements to Sendai's economic situation since the close of the pandemic.

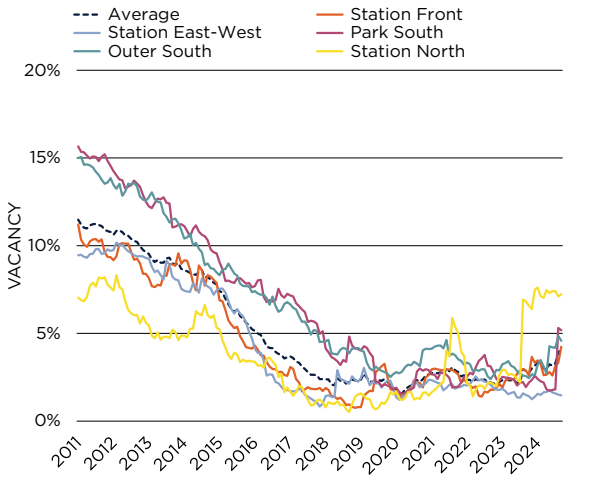
Outlook

Further improvements have been made in the Sendai office market this year, and we anticipate that this positive trajectory should continue for the meantime. Rental growth has been positive in 2024, and vacancy rates continue to tighten overall. Additionally, new office supply has been limited in 2024 and beyond, which should provide greater breathing room for the market.

The central districts of Sendai have been undergoing large-scale regeneration as part of the Sendai Central Redevelopment Project since 2019. Although the project initially aimed for completion by FY2023, labour shortages and high construction costs have led to the project being extended to FY2030. As such, incoming new office supply has been more spaced out, enabling steadier absorption by the market.

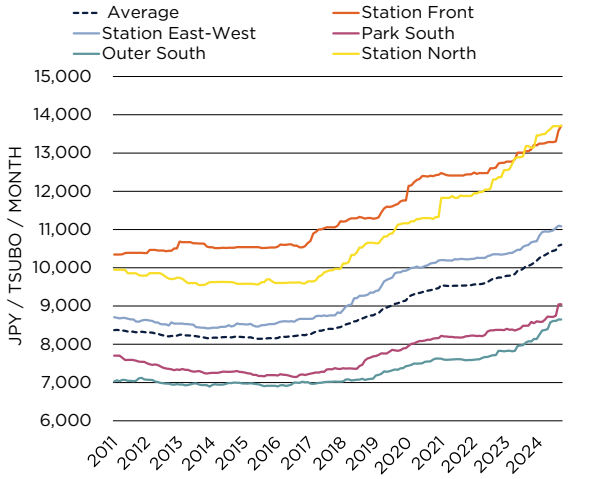
Looking ahead, Sendai's fundamentals are sound, and moderate growth in its working-age population, in addition to ongoing economic recovery and strong corporate activity signal that corporate demand for office space should remain sound for the meantime.

GRAPH 17: Vacancy Rate in Sapporo City by Area, 2011 to Q3/2024



Source Miki Shoji, Savills Research & Consultancy

GRAPH 18: Average Rent in Sapporo City by Area, 2011 to Q3/2024



Source Miki Shoji, Savills Research & Consultancy

SAPPORO CITY

Supply and Demand

Sapporo will welcome an incoming NRA of nearly 11,000 tsubo in 2024, marginally less than the volume seen in 2023. Overall, leasing activity appears to be firm in Sapporo, and fluctuations in the market are expected to be minimal. A handful of moderately large offices were completed over the past half-year, including Sosei Cross in the Outer South submarket which added around 3,000 tsubo of NRA, and the 2,500 tsubo CONNECT SAPPORO in the Park South submarket.

Looking ahead, Sapporo is forecast to welcome similar levels of new supply in 2025 and 2026, at around 10,000 tsubo annually, with numerous large scale office projects underway near Sapporo station and Odori park that should polish the landscape of the city. Firm demand for office space among IT firms, call centres, as well as semiconductor-related companies should ensure the smooth absorption of incoming office space.

Vacancy

The average all-grade vacancy rate in Sapporo loosened by 1.1ppts HoH to 4.1% in Q3/2024. While temporal fluctuations were likely given the relatively large new office supply, many major office buildings arrived to the market largely leased, and vacancy remains low overall.

The Park South submarket experienced the greatest increase in vacancy, at 3.0ppts HoH to 5.2%. CONNECT SAPPORO delivered over 2,500 tsubo of office space in the submarket, partly contributing to this elevation, which is likely to be transient. Elsewhere, vacancy in the Station Front submarket increased by 1.6ppts to 4.2%, stemming from two moderately large office additions in the second half of the year that came to the market with some vacancy.

Rent

Rental growth continues unabated in Sapporo in 2024, with average asking rents increasing by 2.7% HoH to JPY10,600 per tsubo. This likely stems from the completion of large amounts of new office space, which appears to have been well received.

Asking rents increased across all submarkets in the city over the past half-year. Park South experienced the largest rental increment at 4.7% HoH. Similarly, the most expensive submarkets, Station Front and Station North enjoyed moderate rental growth of 3.5% HoH and 1.6% HoH to JPY13,700, respectively. We predict that this trend will continue given the general strength of corporate performance.

Outlook

Prospects appear bright for the Sapporo office market. Its sound fundamentals have contributed to sustained rental growth and manageable levels of vacancy. Large amounts of new office space should be welcome additions to the market, due to the relatively high proportion of offices built before the revised earthquake safety code in 1981. The positive leasing performance of recently completed offices with premium rental levels should be an encouraging sign for the incoming supply.

Bright spots moving forward for the Sapporo office market include the development of the Rapidus semiconductor manufacturing facility in Chitose, which is scheduled to commence mass production by 2027. The positive ripple effects should support further growth in demand for office space.

Moreover, the Hokkaido shinkansen extension should unlock new demand for office and other commercial spaces in Sapporo over the coming decade, and is a major impetus for widespread regeneration activity, particularly in the vicinity of Sapporo station.

Overall, the Sapporo office market should continue to perform well. Moreover, the labour shortage and elevated construction costs should delay or force redesigns to upcoming office developments, providing the market with more breathing room to absorb existing office space, and stabilise the market further.

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