KEYNOTE INTERVIEW

Building value-add momentum in Japan

Interest in the Japanese market has increased steadily since the GFC, and sentiment remains positive – particularly for value-add players, says TPG Angelo Gordon's Tetsu Yaoka

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The Japanese real estate market has undergone significant changes since the global financial crisis, driven by the economic policies of former prime minister Shinzo Abe and a period of aggressive monetary easing by the Bank of Japan. "Abenomics" became synonymous with negative interest rates and large-scale asset purchases, ushering in a significant decline in borrowing costs and providing a major boost to both local and international real estate investment.

While the pandemic created a temporary investment lull, Japan's reopening in 2022 saw renewed interest in tourism-related real estate and other commercial properties. In today's low but rising interest rate environment, the market offers attractive opportunities for value-add players who do not rely on cap rate compression or improvements in market fundamentals, says Tetsu Yaoka, co-portfolio manager of Asia Real Estate and head of Japan Real Estate with TPG Angelo Gordon in Tokyo.

Q What trends are you seeing in the Japanese real estate market from a macro and dealflow perspective?

Japan's real estate investment landscape remains robust thanks to a stable market environment, which in turn is supporting strong liquidity. We see sustained demand from institutional investors across core, value-add and opportunistic strategies.

For the first time in 30 years, we are seeing modest inflation in Japan, which should lead to higher market rents. There are some concerns about potential rate hikes by the Bank of Japan, but so far, cap rates have remained stable. That is largely due to the wide, positive spread between cap rates and borrowing costs, as well as the rental growth expectations by core investors.

Interest rate hikes in the US and Europe in 2022 resulted in investors becoming more cautious about the global real estate market, but Japan has been an exception and institutional investors have continued to invest heavily in the Japanese real estate market, particularly in core return strategies.

Another key trend is the strength of the office market in Japan. In other markets around the world, the office sector has been heavily impacted by remote working and therefore diminished tenant demand. In contrast, the office market in Japan remains robust with limited remote working, very low vacancy in major cities like Tokyo and Osaka, and strong liquidity for core, stabilized assets.

Q What opportunities are you seeing in the Japanese real estate market today, and what is your outlook for the market in the months ahead?

We see significant opportunities as the result of the emerging presence of activist funds engaged in the public equity sector. We believe this should result in the sale of non-core real estate assets as corporate owners look to improve their balance sheets and return on equity ratios. Many of these properties are under-managed, which should present attractive investment opportunities for value-add players who are positioned to take advantage of these divestitures.

In addition, there are currently many listed J-REITs trading below net asset value and therefore facing challenges in raising fresh capital. As a result of this weak J-REIT environment, we expect several J-REITs to sell off some of their under-performing assets to create liquidity, creating further buying opportunities for value-add fund managers.

Lastly, ESG is becoming a very important factor in the decision-making for both Japanese tenants as well as Japanese core investors. There is an opportunity to implement ESG initiatives in Japanese properties through additional capex and certification programs that will significantly improve the attractiveness of these assets.

Q Are there any key sectors in Japan seeing value-add opportunities right now? And what is driving those sectors?

We see strong value-add opportunities across three sectors: office, industrial and hospitality.

The office sector in Japanese cities continues to demonstrate significant strength in contrast to other cities around the world. It is the largest real estate sector in the country in terms of transaction volume, and compared with many other global markets, Japan's office fundamentals remain strong. Tenant demand is healthy, vacancy rates are low and liquidity is high, particularly among domestic investors.

In the fourth quarter of 2024, the all-grade office vacancy rate in Tokyo fell by 0.5 percentage points quarter-on-quarter, dipping below 4 percent for the first time in three years. This low vacancy rate in Japan is largely due to the low adoption of remote work. Work from home is not common, and most employees have fully returned to their offices post-covid, given the importance of the office culture in Japan.

In addition, because the average

Q Can you comment on the market challenges, risks and uncertainties that are currently impacting the Japanese real estate sector?

We are actively monitoring two primary risks. The first is the potential for further interest rate hikes by the Bank of Japan. Japan's political and economic environment suggests that the BoJ will take a cautious approach to rate increases, but any unexpected rate rises could impact property values. Thus far, despite several rate increases, cap rates have remained stable.

The second risk is the increasing competition in the market. With strong demand from both domestic and international investors, securing attractive deals will become more challenging particularly for new entrants. Established managers with strong investment track records, deep relationships and market expertise will excel in this environment.

home size in Japan is relatively small as compared to other countries, it is difficult for remote work to be sustained over a long period of time. We see attractive opportunities in the older, grade B office assets in major cities like Tokyo and Osaka. These assets are often unrenovated and are in need of active asset management to improve cashflows. Once stabilized, these properties are highly sought after by a deep pool of core investors.

In the industrial sector, while vacancy levels have risen recently due to a short-term supply wave, we believe there will be a market recovery over the next two years as supply is constrained due to high construction costs. Tenant demand continues to be consistent and strong, which will help to absorb the newly supplied industrial product.

Additionally, there remains a significant shortage of modern logistics product as only about 15 percent of the total industrial supply in Japan is considered 'modern,' and many tenants are still in older facilities and are looking to upgrade. In terms of liquidity, stabilized industrial properties continue to trade at very attractive cap rates.

The hospitality sector is another particularly exciting opportunity in Japan. The country is experiencing record inbound tourism, supported by government initiatives and a weak yen. The favorable exchange rate has made Japan a top destination for foreign travelers and is limiting outbound travel, which in turn is boosting domestic tourism.

Japan saw almost 37 million inbound visitors in 2024, a record high, and the government has set a goal of welcoming 60 million visitors by 2030. As a result of these strong underlying factors, the hospitality sector remains an attractive investment prospect for both foreign and domestic buyers.

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Q How has institutional investor sentiment evolved in Japan specifically?

There is a very strong domestic institutional investor base in the Japanese real estate market. Historically, these investors have focused on core real estate investments, but in the current rising rate environment, many are now increasing allocations to value-add strategies to enhance returns.

This move up the risk and return curve by these investors will ultimately benefit fund managers who have strong track records and are well-positioned to capitalize on this increase in demand for value-add real estate.

Q How has the launch of the TPG AG Japan Realty Value Fund last year tapped into demand from Japanese institutional investors?

Two key elements have contributed to our success.

First, since we began investing in Japan back in 2010, we have successfully focused on a value-add approach. We concentrate on proactive asset management and creating alpha, a strategy which allows us to protect the downside in different market cycles. Typically, after acquiring an asset, we make significant improvements to enhance a property's cashflow through renovation or repositioning and ultimately maximize our returns.

Second, we place a strong emphasis on accessing off-market or limited marketing dealflow. By leveraging our long-term relationships with our Japanese business partners, we are often able to secure opportunities that are not widely available in the market and at attractive pricing.

Dealmaking is ultimately about relationships. A combination of an impeccable reputation in the marketplace, strong mutual trust with our partners and local expertise gives us access to unique, high-quality investment opportunities. We have built strong alliances over the past 15 years with lenders, operating partners, brokers and other business partners, and these long-term relationships are a key component of our investment strategy. ■