

Japan's hotels a sweet spot for investors

Robust domestic travel and sharply rising inbound tourism are creating an investment opportunity in the Japanese hotel sector

Demand for accommodation has seen

exponential growth in Japan in recent years. This is due to a thriving tourism industry with record arrivals every year since 2013. In 2016 alone, Japan welcomed 24 million visitors. They stayed a total of 70.8 million hotel nights, a nearly fourfold increase from 2011.

A number of factors are contributing to this surge in international arrivals: currency movements, a relaxation of visa requirements and the burgeoning Asian middle class. China alone accounted for a quarter of all tourist arrivals into Japan in 2016. Some 85% of visitors to Japan come from Asia.

Meanwhile, battling the international tourist for hotel space are the Japanese domestic business and leisure travellers. In 2016 they accounted for close to 80% of total hotel stays. Home-grown demand has been historically stable, and this consistency buffers Japan's hotel sector against risks arising from geopolitics, policy, and shocks to the global economy.

A shortfall in a fresh supply of hotel rooms relative to the growth in demand provides an opportunity for investors.

Several near-term catalysts with long-term consequences are also set to significantly spur

inbound tourism such as the Rugby World Cup 2019 and the Tokyo Olympics 2020.

The Japanese government is hoping to lift annual inbound visitor numbers to 40 million by 2020, and 60 million by 2030. To support this plan, it is implementing initiatives to expand the capacity at Tokyo's Haneda and Narita airports. Regional airports will also waive a portion of landing fees to encourage low-cost carriers to open new routes.

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Further, the enactment of the "Japanese casino law" in 2016 paves the way for the development of integrated resorts. Japan is projected to become the second biggest casino market in Asia, and third largest in the world, behind the United States and Macau.

While these catalysts will generate a spike in visitor inflows in the coming years, UBS Asset Management sees the investment opportunity as fundamentally driven by structural rather than cyclical factors.

"The number of visitors to Japan is still low compared to other countries. Tourist arrivals into Japan are only a third of that enjoyed by France and the United States. With the relaxation of visa requirements and government investment in transport and tourism, inbound traffic has much more room to grow," explains Toh Shaowei, analyst for Research & Strategy at UBS Asset Management.

The investment sweet spot is in "limited service hotels," according to UBS Asset Management. These hotels typically offer smaller rooms and are "limited" only in their amenities such as gyms and conference facilities. They are favoured by domestic travellers and are increasingly attracting international visitors for their convenient locations and compelling price points.

"Because of the keen competition in terms of pricing and asset sourcing in the Japan market, we believe the astute entry strategy for investors

Overseas tourist arrivals in 2016 (person, millions)



Source: CIBC, WTO, UBS Asset Management, Real Estate & Private Markets (REPM), as at April 2017; Notes: *denotes 2015 numbers; otherwise data as at 2016

looking at the hotel sector is in value-add projects such as refurbishment of existing hotels and re-purposing of buildings, and hotel development projects with a pre-determined operator," says Graham Mackie, Head of Real Estate Asia Pacific at UBS Asset Management.

Commercial real estate and hotel assets in Japan are tightly held by domestic investors and J-REITs. Few investment funds, if any, represent a pure Japan hotel play. To make the opportunity accessible to global investors outside of Japan, UBS Asset Management is deploying its strategy via its long-time joint venture with Mitsubishi Corporation.

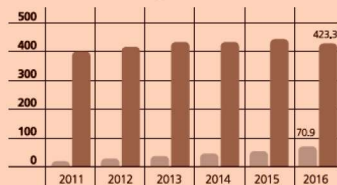
"Mitsubishi Corp-UBS Realty is one of the largest real estate firms in Japan. It has around 150 staff, including more than 20 highly-experienced acquisitions hunters who get to see 80% of all sizeable deals in the market. This joint venture gives us market leading capabilities in deal sourcing and asset management," says Mackie.

Investors that have traditionally invested in office and retail property are now gravitating toward hotels to seize the sweet spot and gain exposure to a real estate segment that is poised to outperform.

Visit www.ubs.com/japanhotels or contact chris.vanbeek@ubs.com or james.yeo@ubs.com for more information.



Number of stays made in 2016 by foreign and domestic travelers (nights, millions)



■ DOMESTIC ■ FOREIGN

Source: Japan Tourism Agency, Ministry of Land, Infrastructure, Transport & Tourism as at June 2017