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Spotlight  
**Capitalising on Japan's  
new tourist trends**

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# Spotlight

## Capitalising on Japan's new tourist trends



“After several years of robust growth, Japan’s hospitality market is seeing some evidence of bifurcation. Supply increases and peer-to-peer accommodation have pressured the budget sector, while high-end hotels have performed better. The playing field is likely to level as the government targets peer-to-peer accommodation with new regulation. Other demand factors are likely to stimulate overall growth, especially in outlying regions.”

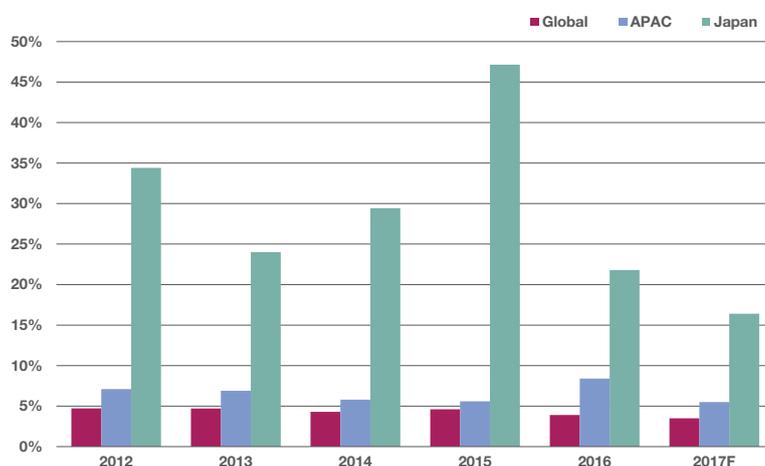
### Japan's path to becoming a tourism nation

Japan’s exponential growth in inbound visitors reflects its advancing position as a global tourism destination. Japan placed fourth in the World Economic Forum’s 2017 Travel & Tourism competitiveness ranking, lagging only Spain, France, and Germany. Japan’s performance scores have risen more than those of any other country since 2015.

Growth in annual inbound tourists to Japan has averaged 18.7% since

2010. This is significantly faster than the global average of 4.5% and the Asia Pacific (APAC) average of 6.6%. During the period, Japan has increased its share of total inbound tourists in APAC from 4.2% to 7.9%. Although Asian tourists make up the bulk of the increase, visitations from Europe, North America, and Oceania have also continuously recorded double-digit growth. Japan is establishing its presence as a global destination that draws travellers from all over the world.

GRAPH 1  
Visitation growth, 2012–2017F\*



\* Global and APAC 2017F based on UNWTO projections. Japan 2017F based on year to date JNTO figures. Source: United Nations World Tourism Organization (UNWTO), Japan National Tourism Organization (JNTO), Savills Research & Consultancy

## SUMMARY

- More international tourists are expected to visit regional cities as the number of repeat visitors increases and the Japanese government works to spread the benefits of tourism to regional economies.
- While there are signs of “minpaku” (peer-to-peer accommodation) businesses eroding the budget hotel sector, competition appears to be evening out due to government regulations and a crackdown on non-compliant establishments.
- Mid to high-end hotels are less exposed to supply increases, and market players can mitigate risks by working with brands and collaborating with local partners in untapped markets.

Comparing Japanese Average Daily Rates (ADR) to those of other global cities, however, shows that the Japanese hotel market still has room to grow. Average ADRs in New York and Paris are almost 50% higher than the average of Tokyo in US\$ terms. As Japan evolves as an advanced tourism nation and attracts more wealthy travellers, the market for high-end hotels should expand and the average rate should increase.

The development of integrated resorts (IR) is also expected to be a strong driver for Japan’s hospitality industry. By developing IRs, the country can offer new entertainment experiences, on top of existing world-class natural and cultural attractions. IRs would attract a new group of travellers to Japan and create favourable environments for upscale hotel investments. Although it is likely that the first IR projects will emerge in or near major cities such as Tokyo and Osaka, more developments could occur in regional cities if there proves to be enough demand.

### Emerging tourism trends

Repeat visitors to Japan have also increased as the country matures as a global tourism destination. Historically, about 60% of total overseas visitors are repeat travellers. In 2016, about 14.4 of Japan's 24 million visitors had visited Japan more than twice. If the government achieves its targets, 24 million repeat tourists will visit Japan in 2020, about the same size of total international visitors in 2016.

Repeat visitors are likely to have toured Tokyo and possibly Osaka and Kyoto on their first visits and could be more willing to explore regional cities to gain new experiences. Global luxury hotels opening in regional cities such as Niseko, Nara, Nikko, and Kanazawa aim to capture this growing lodging demand.

In order to facilitate this outward movement of international tourists, the Japan Tourism Agency has identified wide-area tour routes with themes and stories. These routes typically envelop multiple prefectures and include various places and activities that international tourists often overlook. By April 2017, a total of 31 model courses were proposed by local communities and certified by the Ministry of Land, Infrastructure, Transport and Tourism (Map 1).

Additionally, the increasing global popularity of shared and alternative housing shows that travellers are seeking more than pillows on which to rest their heads and cookie-cutter hotel services. Tourists, especially millennials, are looking for genuine cultural experiences and opportunities to connect with locals. This trend poses a great opportunity for Japan, which is eager to share its rich culture and history with overseas travellers.

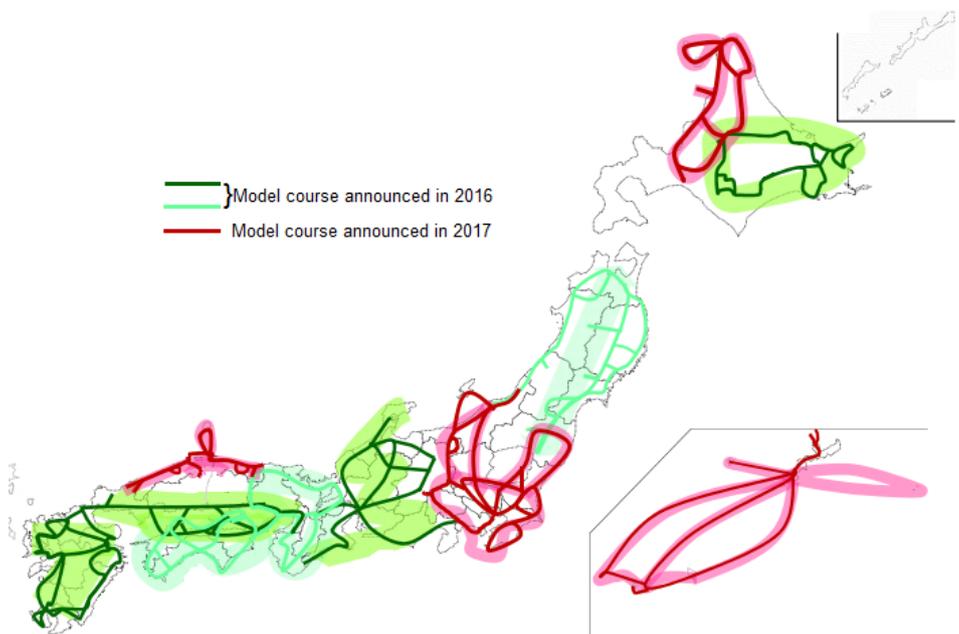
For example, "shukubo", or temple lodging, is becoming increasingly popular especially among western tourists. The UNESCO World Heritage site Mt. Koya accommodated 56,000 international visitors at its 52 sites in 2016. This was about three times more than in 2013, according to the Koyasan Shukubo Temple Lodging Association.

GRAPH 2 **First-time and repeat international tourists to Japan, 2011–2016**



Source: Japan Tourism Agency, Savills Research & Consultancy

MAP 1 **Certified model courses for wide-area tour routes**



Source: Japan Tourism Agency, Savills Research & Consultancy

The explosive growth of minpaku appears to be negatively affecting performances of some budget hotels. Airbnb announced that 3.7 million travellers used minpaku locations listed on its website in Japan in 2016. Shanghai-based Zizaike is also rapidly increasing listings in Japan since the company began its operations here in late 2014.

However, the supply growth of minpaku is expected to taper off as the government increases its effort to crack down on non-compliant locations. According to a study conducted by the Ministry of Health, Labour and Welfare, only 16.5% of minpaku properties listed online are properly registered as lodging facilities. Figures are even lower in

→ major cities – in Tokyo the figure is only 1.8%. New legislation aims to adequately regulate this new business model, which should result in fairer competition with traditional lodgings.

### Increasing competition challenges the budget market

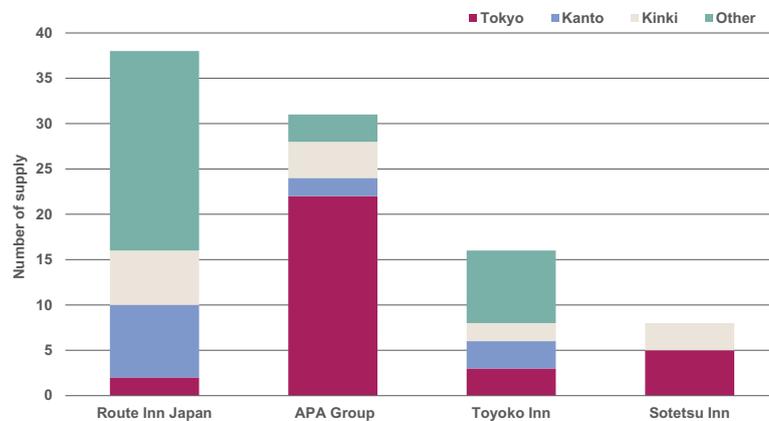
Attracted by upside potential of underlying tourism trends and low borrowing costs, developers are constructing new hotels in gateway cities in a large amount and the development spree is expected to continue in the near term. Hotel brands Route Inn Japan, APA Group, Toyoko Inn, and Sotetsu Inn are major providers of new supply. While APA Group focuses on the Tokyo market, Route Inn Japan and Toyoko Inn are aggressively expanding beyond Tokyo.

About 50% of existing hotel rooms charge between JPY5,000 and JPY12,500 a night, with a long tail extending to the high end of the rate spectrum (Graph 4). Since a majority of new supply is comprised of urban hotels targeting price-conscious business and leisure customers, competition is expected to further increase in the budget sector.

Additionally, increasing usage of alternative modes of lodging appears to be adding supply pressure. In addition to the previously mentioned minpaku business, increasing visitations by cruise ships from neighbouring Asian countries is eroding stays in traditional lodgings because cruise ship passengers do not require land accommodations. The number of foreign travellers visiting Japan by cruise ship has rapidly increased from 174,000 to 1,992,000 between 2013 and 2016.

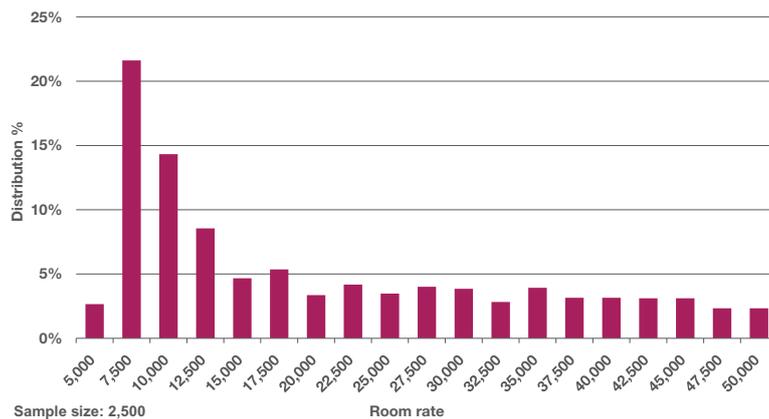
Although it is hard to gauge the impact of minpaku and cruise ships, some available data suggest that they are eating into the traditional lodging market. Since a majority of international tourists need accommodations, the numbers of overseas visitors and international lodging guests usually change in parallel. However, the growth rate of accommodated international tourists registered well below that

GRAPH 3 Hotel supply by brands and regions, 2017–2022



Source: Savills Research & Consultancy

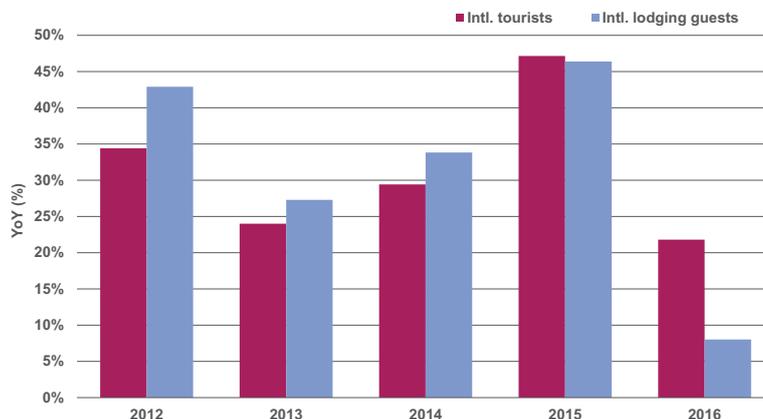
GRAPH 4 Hotel room rate distribution in Japan, 2016



Sample size: 2,500

Simple monthly advertised rates. Does not reflect ADR, which applies to actual bookings.  
Source: Hotel booking websites, Savills Research & Consultancy

GRAPH 5 International tourists vs registered lodging guests\*, YoY, 2012–2016



\* The number of registered lodging guests is the number of guests multiplied by the number of stays.  
Source: Japan National Tourism Organization, Savills Research & Consultancy

→ of total international tourists in 2016. One reasonable explanation for this deviation could be that a large number of overseas visitors are now using new modes of accommodations that are not captured by the statistics, such as unregistered minpaku, cruise ships, overnight buses, airport chairs, and hourly hotels.

The explosive growth of these new lodging modes in recent years is notable, but their future impact in Japan is expected to taper off. Minpaku is coming under tighter regulation, and cruise ship ports are unable to keep up with expanding demand. For example, Hakata Port in Fukuoka has struggled with a number of issues as the number of visiting cruise ships almost tripled between 2014 and 2016. At Naha Port in Okinawa, the local authority rejected 47 cruise ship applications due to overcrowding. As ports are running close to their capacity, it is expected that the current pace of growth via cruise ship visitation will diminish.

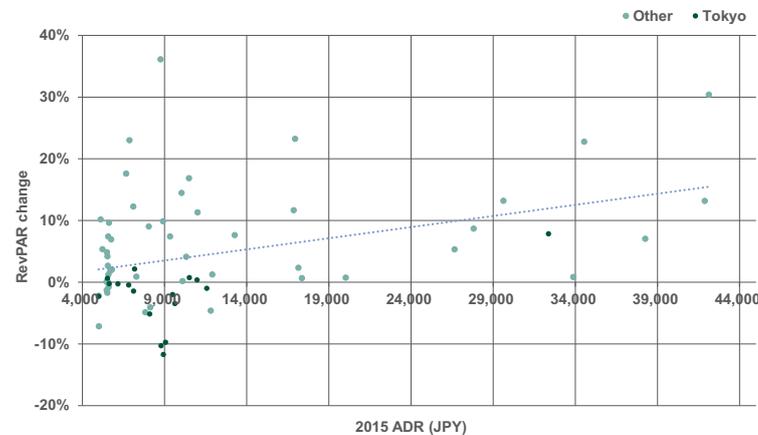
### Mid to high-end hotels

Historically, new mid to high-end hotel supply has been limited. Higher-end hotel developments are risky and difficult due to the need for a large amount of capital, limited availability of desirable locations, and operational difficulties. Hotels may find it hard to acquire trained employees, especially in regional cities. For these reasons, there are high barriers to entry for mid to high-end hotels, limiting supply. However, hotels that are able to overcome these challenges may be able to attain high returns due to less exposure to supply pressure.

Graph 6 plots RevPAR growth rates of hotels owned by three J-REITs<sup>1</sup> between 2015 and 2016, taking 2015 ADRs as the independent variable. Regression analysis shows some correlation between a hotel's ADR and its RevPAR growth. This indicates that hotels with higher ADRs are more likely to have higher RevPAR growth during the surveyed period.

<sup>1</sup> Japan Hotel REIT, Hoshino Resorts REIT, and Invincible Investment

GRAPH 6 J-REIT hotel RevPAR growth by ADR, 2016 vs 2015



To increase data points, Imperial Tokyo and Imperial Osaka are included in the sample. Source: J-REITs, Imperial Hotel, Savills Research & Consultancy

Supply pressure on budget hotels may have contributed to lower RevPAR growth towards the low end of the ADR spectrum. Investing in upscale hotels is likely to limit exposure to supply risk.

One way to mitigate risks in investing in upscale hotels is to obtain affiliations with major global hotel brands (cover photo: Conrad Osaka). Leveraging their networks, experience, and in-depth market knowledge, well-established hotel brands are able to provide expertise and manage development risks. Hotels in regional cities can especially benefit from an established brand's global reservation systems and marketing reach, and use it to promote new destinations. Major hotel brands are also able to shuffle management positions and effectively manage human resources even in regions short of labour.

Collaborating with the right local partners should also improve the chance of successful projects. For example, Mori Trust is developing a JW Marriott-managed facility in Nara on land previously owned by the prefectural government. Nara Prefecture will build a convention centre with retail shops and multi-purpose spaces on adjacent land, which should stimulate new lodging demand in the area.

For existing upscale hotels, rebranding may be an option if owners decide that affiliations with global brands are beneficial and provide a competitive edge. According to Mori Trust, Laforet Tokyo boosted revenues by about 150% after the hotel was renovated and rebranded as the Tokyo Marriott Hotel. Because more hotel guests are seeking unique experiences, soft brands may also be good options for owners who seek benefits from the global infrastructure of major hotel brands while preserving business autonomy. In Japan, Suiran Kyoto, The Prince Gallery Tokyo Kioicho, The Prince Sakura Tower Tokyo, and The Kiroro in Hokkaido are examples of hotels affiliated with these soft brands. ■

## OUTLOOK

### The prospects for the market

Though it is facing supply pressure, the budget hotel sector is likely to enjoy a more even playing field going forward because of new minpaku legislation and recent government crackdowns. Underlying growth of inbound tourists is key to supporting upcoming supply. Because the majority of inbound tourists come from emerging Asian

countries, exchange rates and regional geopolitical risk may play a role.

Mid to high-end hotels are better positioned because they face much less supply and competition, due in part to higher entry barriers.

Regional cities with good infrastructure and tourist attractions have been relatively untapped by

inbound tourists. Considering the growing number of repeat visitors to Japan, those untapped regions should potentially see increased demand.

IR development could open up great investment opportunities over the long term. Investors should keep an eye on the development of the government's selection and approval process.

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