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Savills World Research
Japan

Spotlight
Japan hospitality

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"Japan's hotel sector is still growing despite global economic uncertainty. Tourists continue to visit the country in record-breaking numbers. Revenue and room rates are climbing nationwide. Occupancy conditions are beginning to show signs of slight loosening, although they are still very tight."

International arrivals still growing

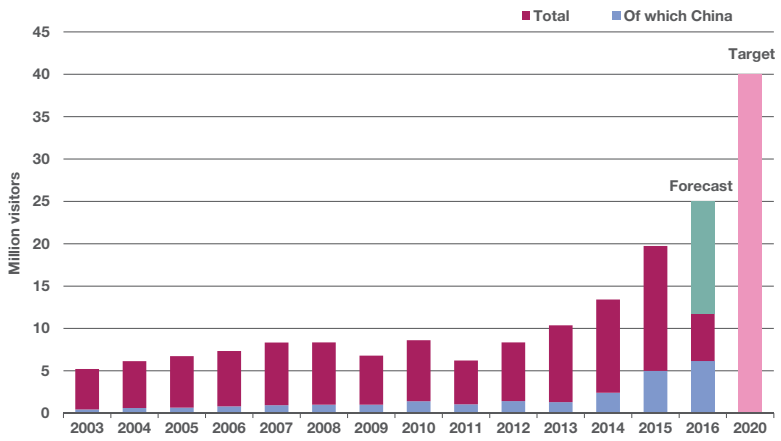
Travellers from overseas continue to flock to Japan. The Japanese tourism industry made headlines earlier this year for attracting a record 19.7 million visitors to the country in 2015, an astounding 47.1% increase vs 2014. This was no blip – international arrivals to Japan have increased by over 20% every year since 2011.

Arrivals continue to grow at a double-digit pace in 2016. Japan has welcomed 11.7 million visitors to its shores as of June, a 28.2% increase over 1H/2015. Though it is doubtful that we will see another 50% increase by the year's end, it is clear that the government's efforts to attract overseas travellers are paying dividends. It can achieve its target of 40 million visitors by 2020 if it can maintain an annual growth rate of 15% for the next five years, which may be optimistic. It is also likely, however, that the 2020 figure itself will see a large bump due to the Tokyo Olympics.

International arrivals still overwhelmingly hail from China, Korea, Taiwan, and Hong Kong. Together they make up over 70% of visitors. North American and European visitors together number less than 5% of the total.

GRAPH 1

International arrivals to Japan, 2003–2016



Source: Japan National Tourism Organization, Savills Research & Consultancy

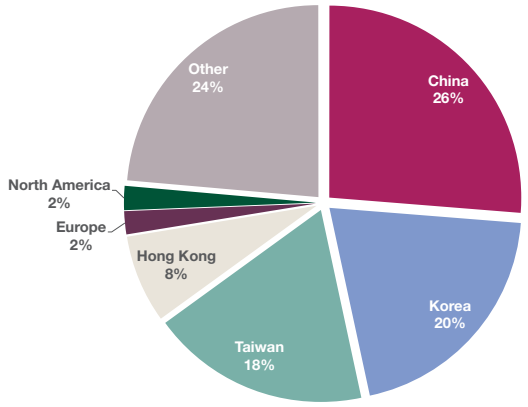
SUMMARY

- 11.7 million overseas tourists visited Japan in 1H/2016, another record high. This is a 28% increase vs 1H/2015.
- Room rates and revenue per room continue to post gains nationwide. Occupancy remains strong at 80.7%, though there has been some pullback. This is probably due to four years of strong, consecutive price increases.
- Developers plan to add an additional 52,000 rooms nationwide as of June 2016, surpassing even last year's 10-year high.
- Hotel transaction volumes have yet again increased, mainly due to a few large deals, despite overall cooling in every other major Japanese real estate sector. Expected cap rates have compressed to 5.0% or below for prime hotel property.
- We expect the recent strong growth rates in room prices, revenue per room, inbound tourism, new supply, and investment to all slightly moderate going forward, but most headline numbers should continue to increase towards the Olympics in 2020.

There has been a slight shift in tourist destinations away from Tokyo and Osaka toward Japan's outlying regions. Data from the Ministry of Land, Infrastructure, Transport, and Tourism shows that the number of overnight stays in Japan's regional destinations is increasing faster than in Tokyo, Osaka, and Nagoya. In response to this shift, the government and private organisations are instituting new programmes to attract visitors to Japan's more undiscovered destinations. For example, in July the Ministry of the Environment selected eight of Japan's 32 national parks to receive special funding and participate in programmes specifically aimed at attracting foreign tourists. Perks of the

GRAPH 2

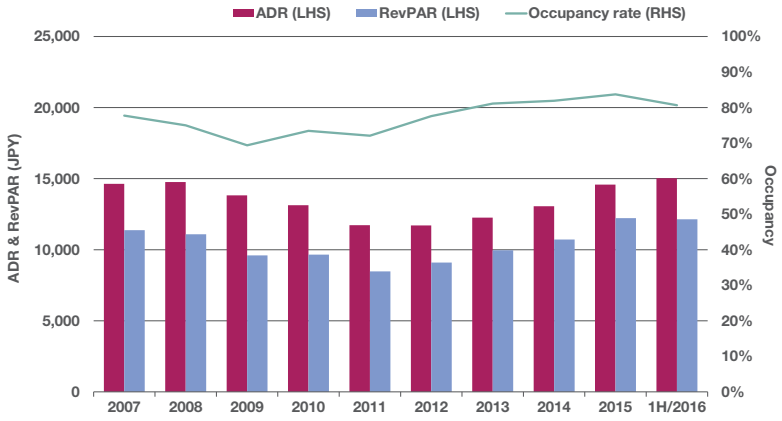
Breakdown of inbound tourists by nationality, 1H/2016 YTD



Source: Japan National Tourism Organization, Savills Research & Consultancy

GRAPH 3

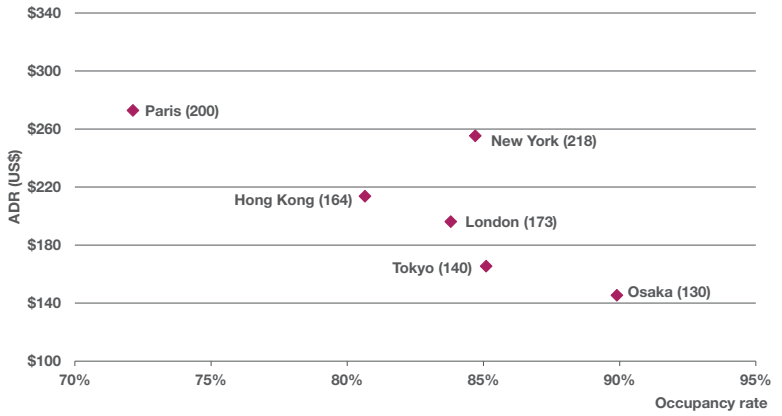
Japan hotel performance, 2007–1H/2016



Source: STR Global, Savills Research & Consultancy

GRAPH 4

ADR, occupancy rate, RevPAR of selected cities, 12 month average ending Jun 2016



Source: STR Global, Savills Research & Consultancy
*Numbers in parentheses show US$ RevPAR

programme include assistance in local hotel renovation, training of special guides, and the easing of regulation on nearby commercial complexes. Selected national parks include Nikko, the resting place of the founder of the Edo-era Tokugawa Shogunate, and Ise-Shima, where Japan hosted the G7 summit earlier this year. Japan's national park system saw 4.3 million overseas visitors in 2015; the Ministry hopes to increase this number to 10 million by 2020.

The private sector is also working hard to capitalize on the tourism boom. In July, Nikkei Business Publications and the Japan Shopping Tourism Organization co-hosted a business conference in Tokyo titled "Inbound Japan", aimed at promoting infrastructure and service solutions for companies seeking to get involved. An estimated 20,000 individuals attended.

Japan hotel market

Consecutive price increases have eased upward pressure on Japan's overall occupancy rates, but average daily rate (ADR) and revenue per available room (RevPAR) are still posting steady gains and are on track to post ten-year highs in 2016. Room prices are still increasing across the country – STR Global reports the national ADR at JPY15,027 over the first six months of 2016, a full 10.0% increase over 1H/2015's average of JPY13,664. RevPAR has likewise increased to JPY12,138 over the same period, up 7.8% from the 1H/2015 average of JPY11,257. This RevPAR is 0.7% lower than the full year 2015 average of JPY12,218, however, due to some moderation especially in occupancy since the 2H/2015.

Consecutive price increases have pulled occupancy back to just over 80% in 1H/2016. The figure moderated to 80.7% nationwide, down 1.6 percentage points (ppts) from the 1H/2015 average of 82.3%.

Even with improving ADR and yen appreciation, room rates in Tokyo and Osaka are still attractive globally in US dollar terms at US$165 and US$145 respectively for the 12 months ending June 2016. Paris, New York, London, and Hong Kong saw higher ADRs of US$273, US$255, US$214 and US$196 respectively during the same period. This gap will narrow if yen strength persists, but the difference

nevertheless implies that Japanese cities still have potential to boost their ADRs. On the other hand, a recent rapid increase in ADR has apparently driven away some tourists, leading to lower occupancy.

In addition, Tokyo's occupancy rate of 85.1% and especially Osaka's rate of 89.9% are still the highest among the cities' peers, despite slight decreases in 2016. Given these high occupancy rates, hotel operators in Japan remain positioned to increase ADR and RevPAR.

Tokyo hotel market

Hotel performance in Tokyo resembles that of the nation as a whole. Occupancy has fallen slightly after remaining largely flat since 2013. ADR and RevPAR are meanwhile continuing their strong upward climb. The average ADR in Tokyo over the first six months of 2016 was JPY19,505, a 10.6% increase over 1H/2015's average of JPY17,640. RevPAR has likewise increased to JPY16,314 over the same period, 6.8% up from the 1H/2015 average of JPY15,275.

Average occupancy in 1H/2016 was 80.7% in Tokyo, representing a decrease of 5.8ppts from the 1H/2015 average of 86.5%. Price increases in Tokyo have been especially strong, possibly driving this moderation in occupancy.

Osaka hotel market

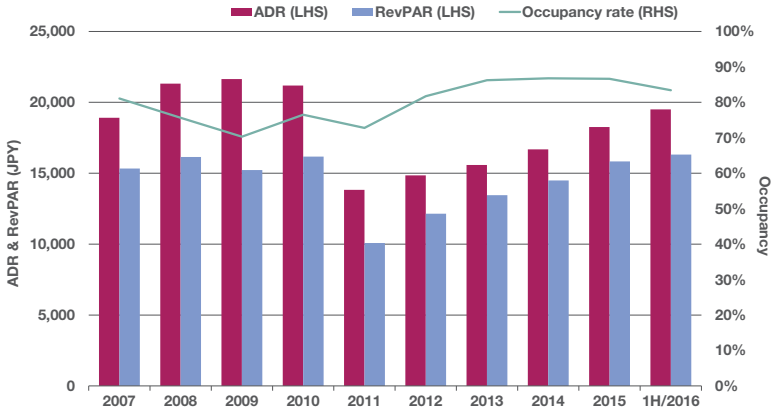
The hotel sector in Osaka has performed very strongly as well, and continues its climb in ADR and RevPAR along with Tokyo and the rest of the country. Both metrics stand significantly higher than they were before the financial crisis, up 32% and 47% respectively from their 2007 averages.

The average ADR in Osaka over the first six months of 2016 was JPY16,557, a 12.2% increase over 1H/2015's average of JPY14,762. RevPAR increased to JPY14,618 over the same period, 10.0% higher than the 1H/2015 average of JPY13,295.

Osaka's average occupancy in 1H/2016 was 88.2%. This is down 1.7ppts from the 1H/2015 average of 89.9%, but still extremely high. Hotel rooms are booked much closer to capacity in Osaka than they are in Tokyo or Japan as a whole.

GRAPH 5

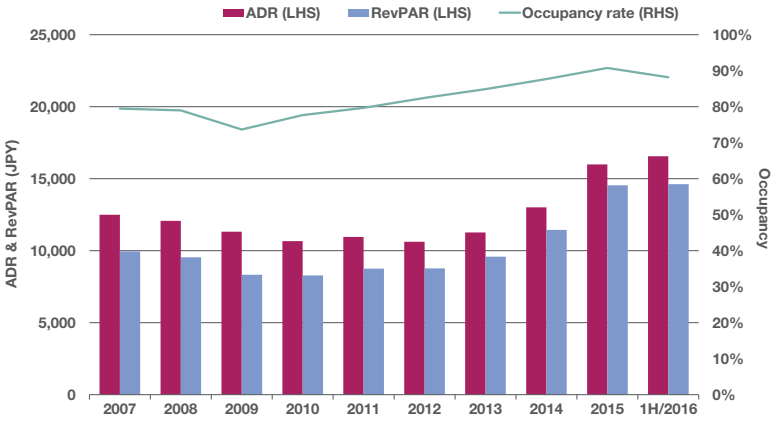
Tokyo hotel performance, 2007–1H/2016



Source: STR Global, Savills Research & Consultancy

GRAPH 6

Osaka hotel performance, 2007–1H/2016



Source: STR Global, Savills Research & Consultancy

Hotel pipeline

As of June 2016, Japan's planned supply of new hotel rooms hit another 10-year historical record, driven partially by strong growth in inbound tourism. A large earthquake in Kyushu in April seems to have further delayed some construction that was already behind schedule.

The pipeline varies across areas. Tokyo and Ginza lead the pack – Hoshinoya Tokyo and The Prince Gallery Tokyo Kioicho both opened in July, adding over 300 deluxe rooms. Hoshinoya Tokyo is located in Otemachi and styled to evoke a traditional Japanese inn. It boasts natural hot spring water despite being located in the central business district of Tokyo. The Prince Gallery Tokyo Kioicho is both part of Starwood Group's Luxury Collection and also the most luxurious hotel of Prince Hotels, a franchise of railway operator Seibu Group. Meanwhile, a JV led by Sumitomo Realty & Development won a proposal bid to construct three hotels by Haneda Airport totalling 1,704 guest rooms. The facilities are scheduled to open by June 2020, just before the Tokyo Olympics.

Kyoto and Osaka are also active. Four Seasons Hotel Kyoto is scheduled to open this autumn, which is likely to draw overseas tourists because there are still few international luxury hotels in Kyoto. In Osaka, the Nikkei reports that of all construction projects 2,000 sq m or more submitted to the Osaka city government since 2014, 52 of 65

commercial projects are either full hotels or mixed-use developments containing hotel space.

Farther north, Mori Trust is proceeding with plans to develop a long-term stay resort in Tomakomai, Hokkaido, focused on natural relaxation and therapy through nature. Stakeholders hope to draw wealthy overseas customers.

In June the government announced that it will relax FAR requirements for businesses catering to overnight guests, which some worry may loosen supply.

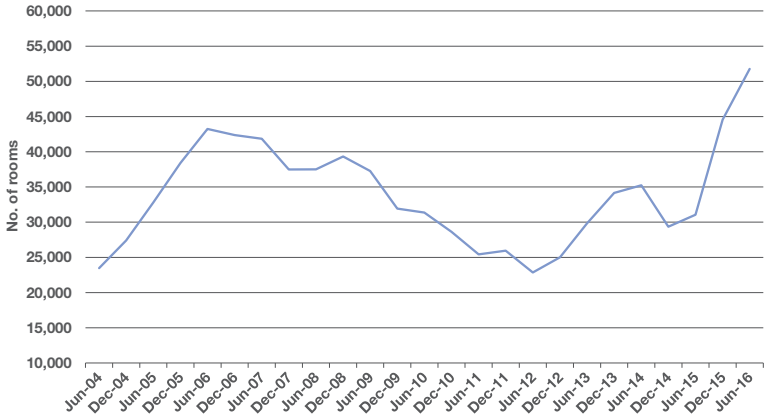
Investments

The hotel investment market has seen a series of large transactions in 2016 even as other sectors of Japan's real estate market have retrenched. Japan's explosive growth in inbound tourism and its chronic lack of room supply are combining to create real interest in the hotel market, and players are leaping to take advantage. According to data from Real Capital Analytics (RCA), hotel investment across Japan totalled 162 billion yen in 1H/2016, up 62% from the same period a year ago.

Despite this increase in volume, the number of transactions has decreased. RCA data indicates that 25 transactions closed from January through July 2016, less than half of the 62 transactions that occurred over the same period a year ago.

GRAPH 7

Planned new hotel rooms, Jun 2004–Jun 2016



Source: Hoteres 3 June 2016, Savills Research & Consultancy

J-REITs or their sponsors were the buyers in 10 of the 25 transactions. This total does not include a recent portfolio acquisition of 10 regional hotel properties by Ichigo Hotel REIT, however, announced in late July and closing on August 17. The REIT specifically cited increasing tourism to Japan's regional destinations as a major reason for the acquisitions.

Other market players continue to announce plans for future developments and activity. Spa operator Oedo-Onsen Holdings has announced that it plans to list the world's first-ever hot springs REIT as early as August with an anticipated AUM of almost 27 billion yen. It will subsequently acquire three to five sites yearly to help develop local economies. The Real Estate Investor Survey by the Japan Real Estate Institute (JREI) reports that expected cap rates on economy hotels in prime Tokyo locations have compressed from 5.4% to 5.0% since 1H/2015. Hotel transactions frequently occur outside the nation's capital, however – only seven transactions occurred in Tokyo in 1H/2016, according to RCA – resulting in a wide range of cap rates. We assume actual transaction cap rates to be much lower than JREI's surveyed figure of 5.0% because winning bidders tend to expect aggressive increases in ADR.

TABLE 1

Planned new hotel rooms, Jun 2016

	Tokyo	Greater Osaka	Greater Nagoya	Greater Tokyo	Okinawa	Other	Total
2016	3,407	1,349	1,505	1,218	266	2,130	9,875
2017	4,485	4,861	2,780	1,921	1,735	5,363	21,145
2018	1,382	445	0	1,000	610	990	4,427
2019	2,557	1,067	0	2,738	488	489	7,339
2020	819	150	0	200	660	200	2,029
TBD	322	654	511	1,124	3,021	1,316	6,948
Sub total	**12,972**	**8,526**	**4,796**	**8,201**	**6,780**	**10,488**	**51,763**

Source: Hoteres 3 June 2016, Savills Research & Consultancy

TABLE 2

Selected investment transactions, announced Mar 2016–Jul 2016

Property name	Price (JPY bn)	Cap Rate	Location	Buyer
Hotel Grand Pacific Meridian	67.0	N/A	Tokyo	Hulic
Hotel Vista Grande Osaka	28.5	5.0%	Osaka	Japan Hotel REIT
Hotel Mystays Gotanda Station	24.7	4.8%	Tokyo	Invincible Investment Corporation
Hotel Epinard Nasu	21.3	6.8%	Tochigi	Invincible Investment Corporation
Hilton Nagoya	15.3	4.9%	Nagoya	Japan Hotel REIT

Source: Japan REIT, RCA, Savills Research & Consultancy

OUTLOOK

The prospects for the market

We have seen the first signs of moderation after four years of impressive growth. ADR and RevPAR are still increasing across the country, but repeated price increases have started to slightly weigh on occupancy. It is likely that nationwide ADR and RevPAR will record a ten-year high for 2016, but future growth will probably proceed more slowly.

Inbound tourism figures will also likely continue to grow, albeit at a slower pace than in 2015. If strong momentum continues, it is possible the government will meet its target of 40 million visitors by 2020 with aggressive annual growth and a bump from the Olympics. Steady increases in inbound tourism should continue to drive significant investment interest in the hospitality sector.

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