



# Spotlight **Japan hospitality**

August 2018



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“Demand for hotels has kept pace with robust supply, as inbound tourist numbers grow strongly and steadily. Hotel performance is likely to improve due to stricter minpaku<sup>1</sup> regulation. Hotel players with different strategies are increasingly entering the industry, leading to a more mature, competitive landscape with reduced risk premiums.”

## Introduction

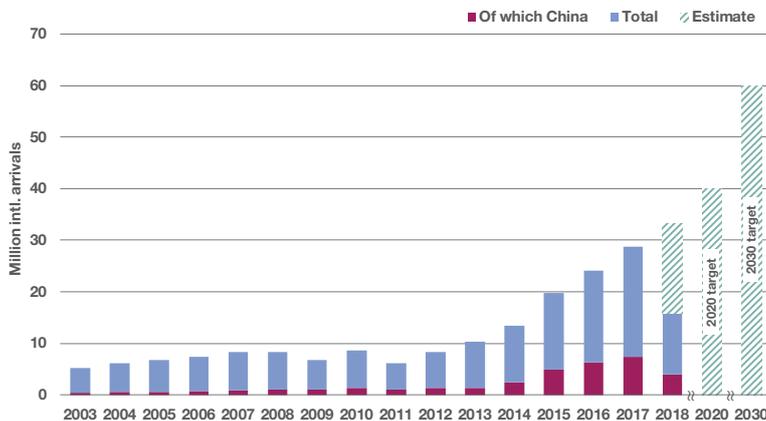
In 1H/2018, the number of overseas tourists to Japan reached 15.9 million, an increase of 15.6% year-on-year (YoY), and their spending over the same period rose 9% YoY to 2.2 trillion yen. The 2020 goal of 40 million annual visitors looked ambitious when first announced years ago, but now appears achievable. Even the goal of 60 million visitors by 2030 seems more realistic. Given the size of Japan’s population and economy, and its extensive and reliable transportation system, there appears to be capacity for further growth.

With a series of events such as the 2019 Rugby World Cup, the 2020 Tokyo Olympics, and possibly the World Expo 2025 in Osaka in store, the country is not short of ammunition. Integrated resorts are also expected to be built at three locations and should induce further arrivals.

Additionally, Japan is aiming to attract more tourists from diverse regions and reduce its heavy reliance on Asian visitors, who currently account for 85% of overseas tourists. Potential increases in non-Asian tourists should have a positive impact on hotels since they tend to spend more on accommodation per trip than their Asian counterparts (Graph

<sup>1</sup> Minpaku is the Japanese term for peer-to-peer accommodation, such as those provided by Airbnb.

GRAPH 1  
Overseas visitors to Japan, 2003 – 1H/2018

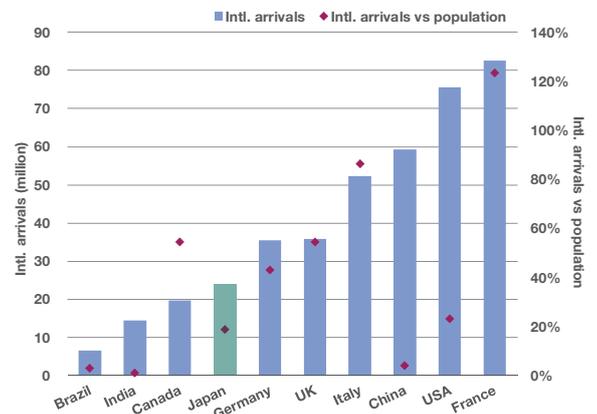


Source: Japan Tourism Agency (JTA), Japan National Tourism Organisation (JNTO), Savills Research & Consultancy

## SUMMARY

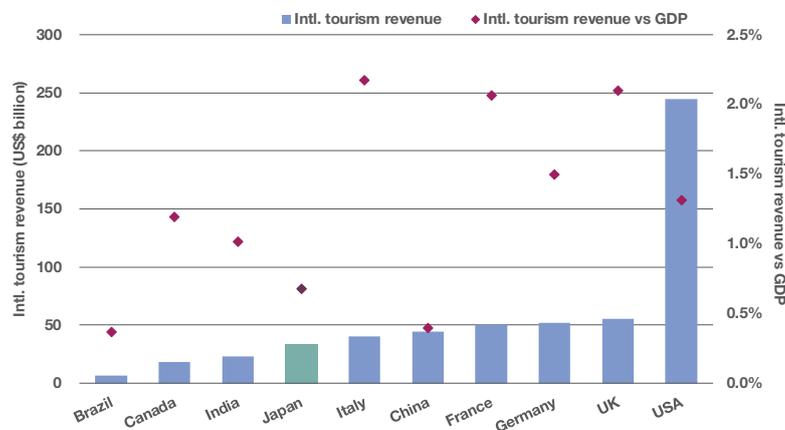
- The number of overseas visitors to Japan has risen 15.6% YoY over 1H/2018, to 15.9 million.
- Inbound tourist spending in 1H/2018 was 2.2 trillion yen, up 9% YoY.
- Marketing initiatives to increase tourism from outside Asia should have a positive impact on hotels for both diversification and profitability.
- Strong occupancy levels and reduced minpaku supply raise expectations of long-awaited improvements in hotel performance.
- New players are entering the hospitality industry, and many operators are adopting different roles and taking different risks, making the industry more mature and reducing risk premiums.
- Investment interest in the hotel sector remained strong in 1H/2018. New supply is likely to help increase future volumes.

GRAPH 2  
International tourist arrivals and % of international tourists vs population, 2016



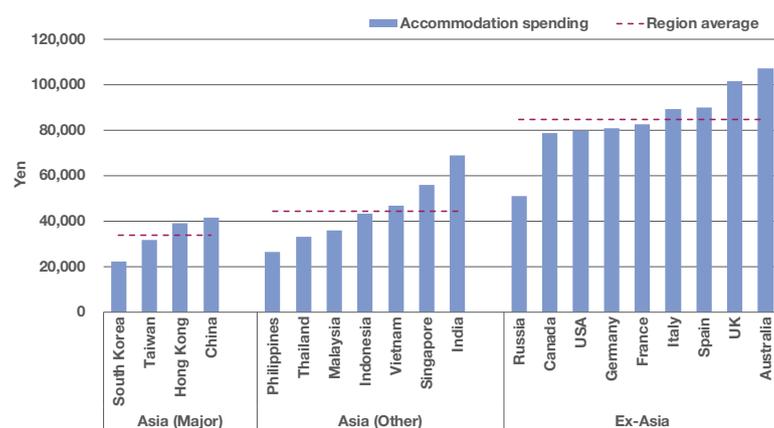
Source: World Bank, Savills Research & Consultancy

**GRAPH 3**  
**International tourism revenue and international tourism revenue vs GDP, 2016**



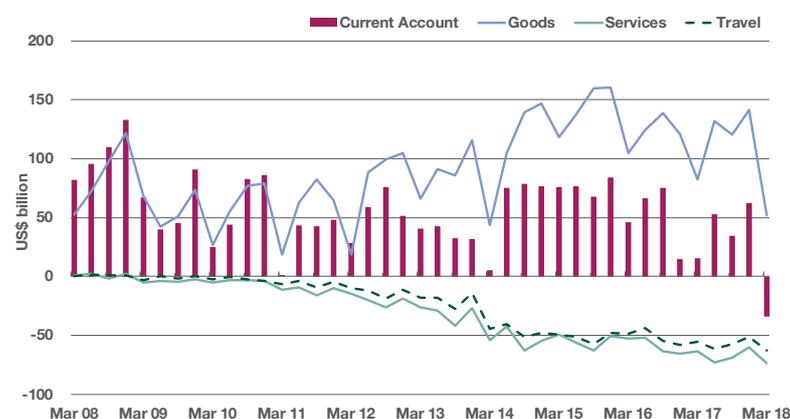
Source: World Bank, Savills Research & Consultancy

**GRAPH 4**  
**Average accommodation spending per trip by nationality, Q2/2018**



Source: JTA, Savills Research & Consultancy

**GRAPH 5**  
**Chinese current account, Mar 2008 – Mar 2018**



Source: State Administration of Foreign Exchange, Savills Research & Consultancy

4). According to the World Tourism Organization, the number of European tourists who visited the Asia Pacific region amounted to 32 million in 2016, while the number of visitors from Europe to Japan in the same year was only a fraction of this at 1.4 million. The government has earmarked a large budget for marketing, which should further support the effort to attract European visitors. Moreover, a new exit tax of 1,000 yen per person is projected to generate over 50 billion yen of revenue annually and will be used, for instance, on multiple language services and increasing the number of Wi-Fi hotspots, in addition to marketing.

Geopolitical ructions in 2018 highlight the benefits of diversifying Japan's sources of tourism. China, which makes up one of the largest proportions of international arrivals, saw its current account surplus flip to a deficit in Q1/2018 for the first time in almost two decades (Graph 5). On top of decreased exports, increased international travel by Chinese nationals has widened the services deficit since 2010. In addition, an escalating trade war with the United States continues to soften the outlook for China's balance of payments. Continued trade war rhetoric or an increasing services deficit could further weaken the renminbi, which has depreciated against the yen by more than 5% year to date, and possibly impact outbound tourism to Japan.

Also, the risks posed by uncontrollable external events became apparent in 1H/2018: heavy rains in areas of western Japan are estimated to have impacted tourist spending by 8.6 billion yen, and a measles outbreak between March and June drove an estimated 3,500 tourists to cancel trips to Okinawa. The Japan market is large enough to accommodate a diversification strategy that could mitigate such risks. Nevertheless, these risks and volatility events are embedded in the hospitality industry.

The main concern of hoteliers continues to be a high level of upcoming supply. As illustrated in Graph 6, total sq m of new lodging construction starts in Tokyo and Osaka rapidly increased between FY2015 and FY2017. Based on the volume of press releases, hotel developments are still being proposed, though forecasts tabulated by industry publication

Hotels show that total planned new rooms only grew by 2.6% between December 2017 and June 2018, well below the average of 24.6% over the last four semi-annual periods. In addition, stable hotel occupancy indicates that supply appears to have grown somewhat in line with demand so far.

New regulation in the minpaku industry appears to have partially alleviated supply concerns among hoteliers. The new regulation significantly reduced the number of Airbnb listings and appears to have opened up some breathing room for budget hotel operators. This could even lead to a hotel supply shortage in the future and trigger long-awaited increases in hotel room rates.

With the hospitality market growing, various investors are adopting different strategies. While J-REITs are shuffling their assets, there is still strong acquisition appetite, especially from new players. Some companies now focus on operating hotels without purchasing the underlying real estate. As various investment options become available, the hotel market is becoming more liquid and mature, reducing risk premiums and thereby lessening downside risk from potential market adjustment.

### Minpaku regulation

On 15 June, registration under the Private Lodging Business Act became mandatory for operators falling under its jurisdiction. The registration process is lengthy, and calls for significant setup costs such as installing expensive fire safety systems. Operating days are restricted to 180 per year and violators face a fine up to one million yen if caught, though local governments are permitted to enforce their own restrictions which have generally been stricter. Kyoto, for example, in principle only permits operation during the low season and for a maximum of 60 days a year in residential areas. These additional burdens discourage both existing and new operators.

Japan is no exception, as Airbnb has been met with regulation in many markets, ranging from restrictions on the number of operating days to fines for unlicensed operators. Strict regulation has a marked effect on appetite to operate minpaku. Fluctuations in minpaku usage can be seen in Graph 7, as the YoY change

in nights stayed by overseas tourists markedly diverged from the YoY change in international arrivals.

As of 13 July, the government registry showed approximately 4,400 approved minpaku providers and just under 1,500 pending approval, far fewer than the 50,000 to over 60,000 listings available on Airbnb's website before June. Stricter legislation appears to have cooled enthusiasm for the sector, evidenced by a return to growth in nights stayed in Q2/2018, which should benefit budget hotels in particular.

Facing stiff resistance from local residents, minpaku listing portals are looking for new approaches. Airbnb, the largest minpaku listings provider in Japan with about 27,000 listings on its website as of late June, has announced a US\$30 million advertising budget for its Japanese operation. Motivated by bookings of any sort rather than being dependent specifically upon minpaku, Airbnb is also soliciting hotels to list rooms on its website at a fraction of the cost typically charged by online travel agents, which may contribute to an improvement in the operator cash flow. Rakuten Lifull Stay, which expects 1,600 rooms to be available on its platform once all pending applications are approved, has entered into partnerships with Tujia and HomeAway, both of which have long-term interests in Japan themselves. In addition, stricter minpaku regulation has changed major minpaku providers from individuals to corporates and made the competitive landscape fairer for budget hotel operators.

### Japan hotel market

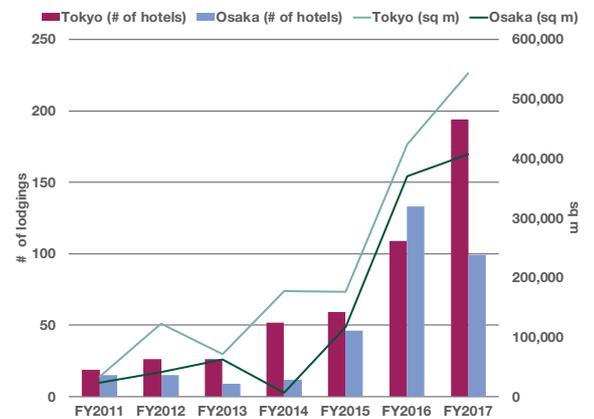
Savills tracks the performance of over 100 hotels owned by five J-REITs<sup>2</sup> to analyse market trends. Our analysis focuses on limited-service hotels; full-service and resort properties are excluded due to limited data. Given that a majority of the existing hotel stock is in the limited-service category, this should provide a good proxy for the overall market trend in Japan<sup>3</sup>.

Though average daily rates (ADR) were marginally lower YoY across our sample, revenue per available

<sup>2</sup> The five J-REITs consist of Japan Hotel REIT, Invincible Investment, Hoshino Resorts REIT, Ichigo Hotel REIT, and Mori Trust Hotel REIT. Since new samples are added when J-REITs acquire hotels, the sample size and composition may change marginally between survey periods.

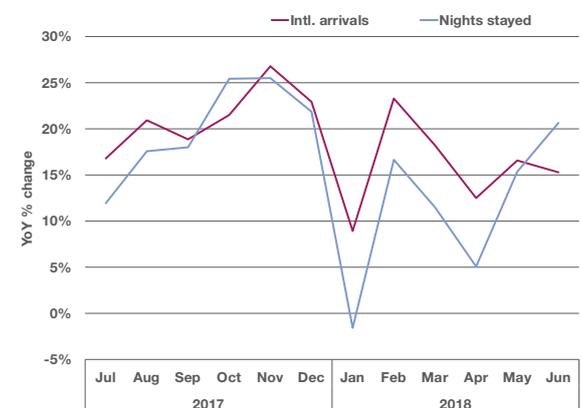
<sup>3</sup> As of this report, Tokyo accounts for over 30% of the sample hotels while other Kanto prefectures and Kansai account for about 15% each.

GRAPH 6  
**New construction starts of accommodation buildings, FY2011 – FY2017**



Source: Ministry of Land, Infrastructure, Transport, and Tourism, Savills Research & Consultancy

GRAPH 7  
**Annual growth in international arrivals\* versus growth in nights stayed, Jul 2017 – Jun 2018**



Source: JTA, JNTO, Savills Research & Consultancy  
\* International arrivals numbers for May and June are preliminary estimates by the JNTO.

room (RevPAR) increased slightly as occupancy rose by 0.7 percentage points (ppts) YoY to an impressive 87.5% (Graph 8). Minpaku supply may have had some influence here: analysis by Smith Travel Research (STR) demonstrates that, globally, ADRs tend to suffer from a reduced number of compression nights<sup>4</sup> as a result of the presence of minpaku. With the apparent contraction of minpaku supply, ADRs should have upward momentum in the future.

According to JTA data, which covers a wider universe than our sample,

<sup>4</sup> Compression nights occur when occupancy exceeds a certain level, typically 95%. Hotels are able to temporarily raise ADRs in these circumstances.

→ occupancy in Tokyo averaged 85% through 1H/2018<sup>5</sup>, with Shibuya occupancy particularly strong at 90% thanks to its popularity as a tourist destination and limited supply. Similarly, Osaka and Kyoto recorded occupancy of 86% and 79%, respectively, as tourists continued to visit in droves.

The nationwide labour shortage is acutely apparent in the physically demanding hospitality industry. According to the Bank of Japan's June Tankan survey, the short-term outlook for hospitality labour supply conditions was the tightest out of all industries. Hourly wages for lodging staff are up 4.2% YoY<sup>6</sup> according to Recruit Jobs (Graph 9), continuing a trend established back in 2013. Prolonged tightening of the labour market has prompted the government to draft a law to welcome 500,000 new workers from overseas to help alleviate the situation.

One way to counter rising costs is through productivity improvements. A 2017 study by the Research Institute of Economy, Trade and Industry showed that an increased proportion of overseas guests, who tend to use hotels at different times to domestic guests, led to more efficient utilisation of hotel rooms and improved labour productivity by as much as 7%. As more foreign tourists visit Japan, this effect should somewhat counterbalance increasing costs.

### Investments

According to Real Capital Analytics (RCA) data, hotel transactions amounting to 140 billion yen took place across Japan in 1H/2018, up 51% YoY. The lion's share was transacted in Tokyo and Yokohama, though Sapporo, Osaka and Fukuoka also captured investor interest. Significant transactions included Hotel Universal

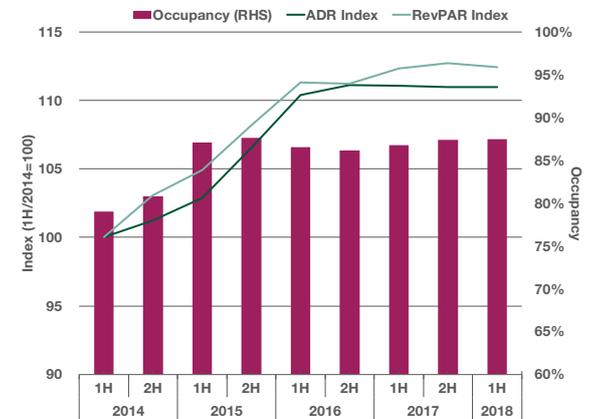
<sup>5</sup> With regard to occupancy levels, 1H/2018 refers to the period from January to May 2018.  
<sup>6</sup> June 2017 to June 2018

Port in Osaka and Rihga Royal Ogura in Kyushu, though multi-property portfolio acquisitions also made up a reasonable portion of transaction volume as investors snapped up opportunities to diversify in one fell swoop. According to the Japan Real Estate Institute (JREI), estimated cap rates on budget hotels in April were 4.5%, 0.2ppt lower YoY, showing the compressing trend.

Multiple major property developers have announced or expanded on intentions to enter the hotel business this year. NTT Urban Development plans to launch a hotel business targeting foreign tourists in Kyoto and Osaka. Mitsubishi Estate intends to open multiple Royal Park Hotels in Tokyo, Kyoto, and Osaka. Mitsui Fudosan has signed an agreement to open Japan's first Bvlgari Hotel in Tokyo. Tokyu Fudosan bought the Kyukaruizawa Kikyo in Nagano and plans to open more luxury hotels elsewhere in Japan. Foreign companies are also making firm commitments. For example, Hilton is expanding its presence in Okinawa, having recently opened the DoubleTree by Hilton Okinawa Chatan Resort (cover photo).

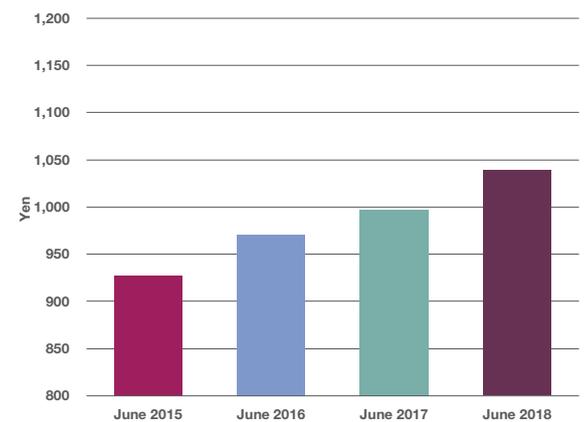
As the hospitality industry matures, various players are taking different strategies and risks. Some are interested in making new investments and divesting old properties, while others are keen to focus on management or operation without repositioning their balance sheets. Minpaku operators can now enlist the services of corporate management agencies and specialise in niche markets where they can add the most value. As the industry further matures, risk premiums should decline and the industry should become more resilient. ■

GRAPH 8 **Trailing-twelve-month limited-service hotel performance, 2014 – 1H/2018**



Source: J-REIT disclosures, Savills Research & Consultancy

GRAPH 9 **Lodging staff hourly wages\***



Source: Recruit Jobs, Savills Research & Consultancy  
 \* Average wage for lodging staff in the three major metropolitan areas in Japan: Tokyo, Tokai and Kansai

TABLE 1 **Selected investment transactions, announced in 1H/2018**

Property name	Approx. price (JPY bil)	Price per room (JPY mil)	Cap rate (%)	Location	Buyer
Hotel Universal Port	34.0	57	4.3	Konohana, Osaka	Orix J-REIT
Rihga Royal Ogura	16.6	56	5.5	Kita Kyushu, Fukuoka	United Urban J-REIT
Hotel MyStays Yokohama-Kannai	5.3	32	4.5	Naka, Yokohama	Invincible J-REIT

Source: J-REIT disclosures, Savills Research & Consultancy

## OUTLOOK

### The prospects for the market

Overseas tourist numbers continue to rise and are expected to fill rooms in popular city destinations. Hotel operators are enjoying an improved outlook compared to six months ago: the rate of increase in future supply appears to have slowed and minpaku supply has greatly decreased, which should allow for better pricing power, especially for budget hotel operators. Minpaku operators, now mainly corporates, must also be compliant with regulations, resulting in fairer

competition. Labour related costs continue to rise, slimming margins, but there are avenues for improving productivity to compensate.

Sporting events such as the Rugby World Cup and the Olympics are likely to serve as catalysts for the hotel market in coming years, topping up already strong demand, as are integrated resorts once they come online. Marketing initiatives to increase tourism from outside Asia should have a positive impact on hotels in terms of both diversification and profitability.

Buyers would like to take advantage of acquisition opportunities, while aggressive sellers refuse to compromise on price and operating assumptions. Developers continue to introduce fresh stock to the market, which should support volumes going forward. Unpredictable events in 1H/2018 serve as a reminder of the risks inherent in the hotel business. Additionally, if economic uncertainty - especially in the Asia Pacific region - deepens, it could deal a blow to this promising sector, at least temporarily.

## Please contact us for further information

### Savills Japan



**Christian Mancini**  
CEO, Asia Pacific  
(excl. Greater China)  
+81 3 6777 5150  
cmancini@savills.co.jp

### Savills Research



**Tetsuya Kaneko**  
Director, Head of Research  
& Consultancy, Japan  
+81 3 6777 5192  
tkaneko@savills.co.jp



**Simon Smith**  
Senior Director  
Asia Pacific  
+852 2842 4573  
ssmith@savills.com.hk

### Savills Hotels



**Raymond Clement**  
Managing Director  
Asia Pacific  
+65 6415 7570  
rclement@savills.com.sg



**Tomotsugu Ichikawa**  
Director  
Japan  
+81 3 6777 5184  
toichikawa@savills.co.jp

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