



Spotlight **Japan hospitality**

September 2015



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“The number of inbound tourists to Japan has been skyrocketing, giving a robust momentum to the hospitality sector. The burgeoning tourist numbers have driven the strong performance of the hotel market, particularly in Osaka, which has shown phenomenal growth.”

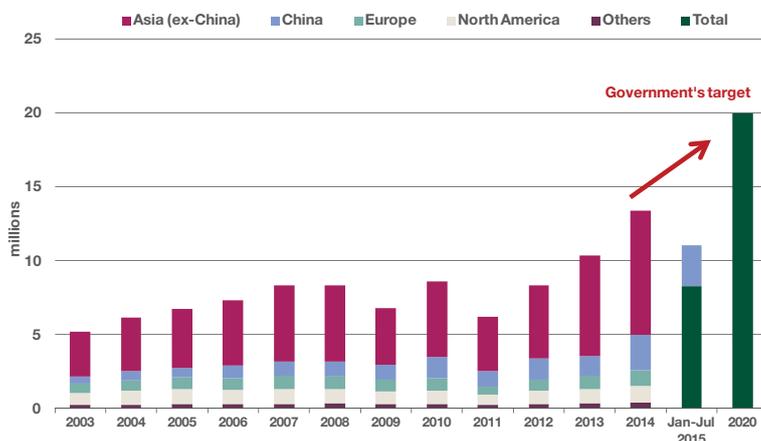
International visitors are rapidly growing

The Japan National Tourism Organization (JNTO) has announced that the total number of international tourists totalled 11.1 million to July 2015, a 47% increase from the same period last year. The increase in inbound visitors has been fuelled by the soft yen and various government initiatives such as airport capacity expansion, the growth of low cost carriers (LCCs), the relaxation of visa requirements and new openings of duty free shops. During 2014, the number of international tourists exceeded 10 million in October and totalled 13.4 million at the year-end. In 2015, the number was over 10 million by July, three months earlier

than a year before. This July saw 1.9 million inbound tourists, up by 51% from the same month last year, a record on a per-month basis. This signifies a shift of the economic drivers in Japan. For the 12 months to March 2015 (Fiscal year March 2015 or FY Mar 2015), Japan's travel balance swung into the black for the first time in 55 years, with foreign visitors spending more in Japan than Japanese tourists spent on overseas travel. The balance changed from JPY530 billion in deficit for FY Mar 2014 to a JPY210 billion surplus for FY Mar 2015.

The Ministry of Land, Infrastructure, Transport and Tourism (MLIT) and JNTO are targeting 20 million arrivals

GRAPH 1
International arrivals to Japan by region, 2003–Q2/2015



Source: JNTO, Savills Research & Consultancy

SUMMARY

- The growth of international tourists has been robust over the last few years and international arrivals have more than doubled between 2011 and 2014. The soft yen and various government initiatives have supported this trend.

- Thanks to rising international tourist numbers and strong domestic business sentiment, the hotel market in Japan has fared well. The occupancy rate in Japan has hovered at around 80% since 2013. However, compared with other large international cities, there is still significant potential to boost revenues.

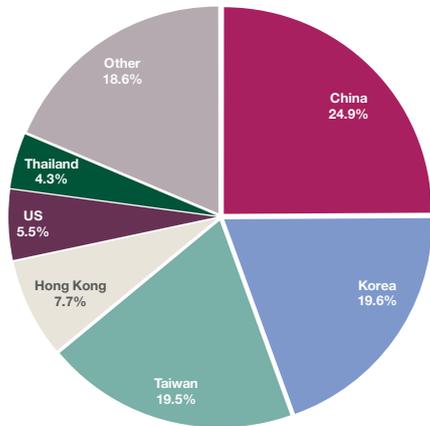
- The Tokyo hotel market has recovered but there is still further room before the market hits 2007/2008 highs. The Osaka market has shown remarkable growth and has hit record highs across many indicators. This phenomenal performance has been given a boost by Universal Studios Japan.

- The hotel investment market has been active and we have seen cap rates compress. J-REITs and their sponsors have been strong buyers. The variable rent structures give J-REITs a significant upside in revenue from hotel portfolios under current market conditions.

- Many well-known hotel brands are planning new openings in Japan, in order to capture the hotel growth story, but it is likely to take some time before the market sufficiently supplied. We are currently seeing some companies convert existing office buildings into budget hotels.

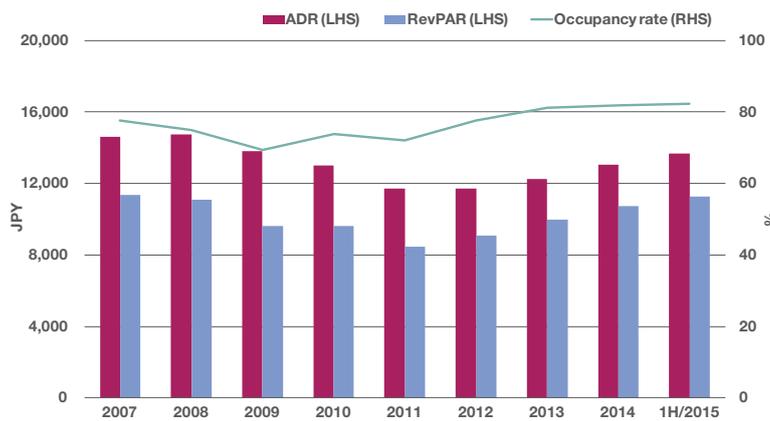
- The hotel sector in Japan is likely to perform well towards 2020 when the Tokyo Olympics will be held. The government is expected to achieve its target of 20 million visitors this year or next year, if current trends continue.

GRAPH 2
Breakdown of inbound tourists by nationality, 2015 to July



Source: JNTO, Savills Research & Consultancy

GRAPH 3
Japan hotel performance, 2007-Q2/2015



Source: STR Global, Savills Research & Consultancy

GRAPH 4
ADR, Occupancy rate, RevPAR of large cities in the world, 1H/2015



Source: STR Global, Savills Research & Consultancy
 * Numbers in the charts show RevPAR

in 2020 – the year when the Olympic Games will be held in Tokyo. This target is likely to be achieved much earlier, possibly this or next year. The number of international arrivals has more than doubled between 2011 and 2014, at a compounded annual growth rate (CAGR) of 29%. The majority of tourists come from Asia, particularly China, Korea and Taiwan. The numbers of visitors from these three countries totalled 2.8 million, 2.2 million, and 2.2 million for 2015 (to July), respectively with the three countries together accounting for 64% of the total inbound tourists to Japan. The number of tourists from China is growing especially rapidly, by 2.3 times between 2011 and 2014. They also have a greater retail spend than other nationalities, contributing to higher revenues for the retail sector.

Japan hotel market

The hotel market in Japan has fared well, due to rising international tourist numbers and buoyant business sentiment at home. The occupancy rate stood at 82.3% during 1H/2015, and has hovered above 80% since 2013. Average daily rates (ADR) and revenue per available room (RevPAR) have recovered as well. The ADR for 1H/2015 was JPY13,664, 4.6% higher than the 2014 figure but still 6.6% lower than 2007. RevPAR during 1H/2015 was JPY11,257, 5.0% higher than the 2014 figure, and almost in line with its 2007 level. The positive market conditions are likely to further spur the improvement of both ADR and RevPAR in the foreseeable future.

In particular, this has positive implications for the international travel sector. Room rates in Tokyo (ADR: US\$146, 1H/2015) and Osaka (US\$123, 1H/2015) are attractive, especially in US dollar terms, partly thanks to a softer yen. During the same period, other large international cities such as Paris, New York, Hong Kong and London, have had ADRs of US\$283, US\$236, US\$210 and US\$208, respectively. This implies that Japanese cities have significant potential to boost their ADR. In addition, the occupancy rate in Tokyo (86.5%, 1H/2015) and Osaka (89.9%, the same period) are the

→ highest among the cities' peers: Paris (75.4%), New York (82.1%), Hong Kong (81.6%) and London (79.7%). Given the very high occupancy rates, hotel operators in Japan seem to be making every effort to increase ADR and RevPAR.

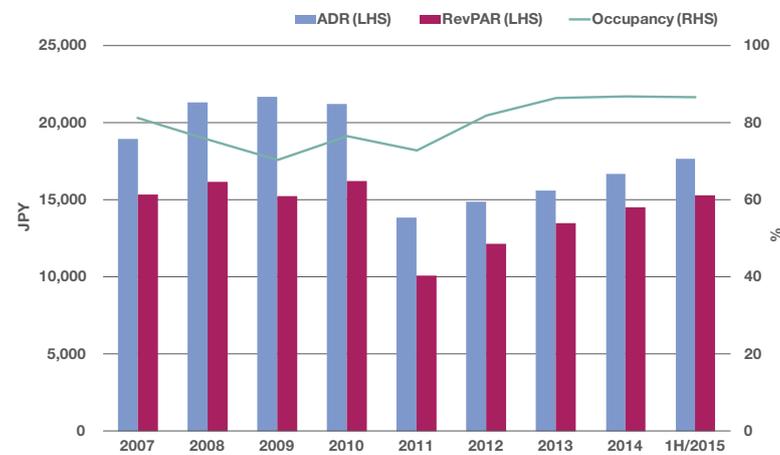
Tokyo hotel market

The Tokyo hotel market is also strong. The occupancy rate has hovered at over 86% since 2013. ADR and RevPAR have recovered but there is still further room for improvement in order to hit 2007/2008 highs. ADR during 1H/2015 was JPY17,640, 5.8% up from the 2014 figure, but still 17.3% lower than its 2008 level. RevPAR during the same period was JPY15,275 yen, only 5.4% lower than its 2008 level because of a higher occupancy rate (86.5% during 1H/2015 against 75.6% during 2008).

It is said that domestic business travellers to Tokyo sometimes find it very difficult to secure accommodation because of this high occupancy rate and high price tag. Many business travellers have a budget limit on accommodation of around JPY10,000 to JPY12,000 per night in Tokyo. As ADR has increased almost by 30% since the 2011 trough, on occasion there are few suitable accommodation options for some business travellers.

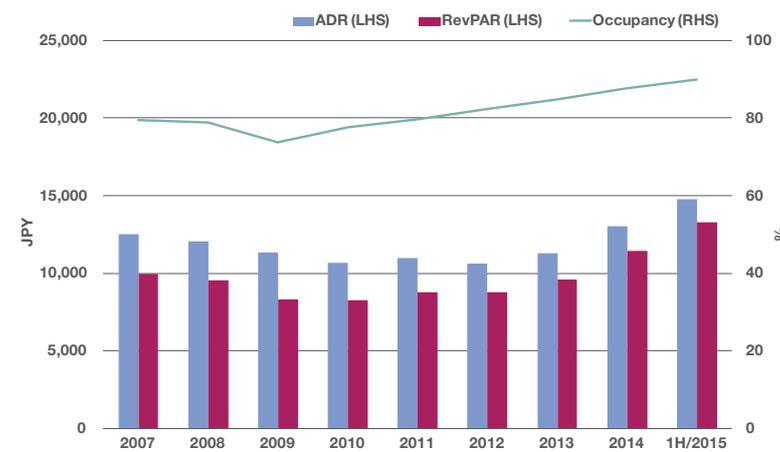
Considering the robust conditions in the Tokyo hotel market, and ADRs which are lagging internationally, the Tokyo hotel market is expected

GRAPH 5 Tokyo hotel performance, 2007-Q2/2015



Source: STR Global, Savills Research & Consultancy

GRAPH 6 Osaka hotel performance, 2007-Q2/2015



Source: STR Global, Savills Research & Consultancy

TABLE 1 Selected investment transactions, 2015 to August

Property name	Price (JPY bil)	Cap rate (%)	Buyer
Four ANA Hotels	40.0	-	Hoshino Resort
Okinawa Marriott Resort & Spa	15.0	6.2	Japan Hotel REIT
Rihga Royal Hotel Kyoto	10.4	-	Fortress
Sotetsu Fresa Inn Ginza 7-Chome	10.0	-	Hulic
APA Hotel Yokohama-Kannai	8.4	5.3	Invincible Investment

Source: RCA, Savills Research & Consultancy

→ to see further increases in ADR and RevPAR.

Osaka hotel market

The Osaka hotel market has recently seen remarkable growth. The occupancy rate during 1H/2015 was 89.9% and has stayed very high (at over 80%) since 2012. ADR also showed a robust two-digit growth in both 2014 and 1H/2015, and stood at JPY14,762 during 1H/2015. RevPAR during 1H/2015 was JPY13,295, 16.2% higher than the 2014 figure. This is the second year of consecutive growth after achieving a 19.4% growth in 2014, from JPY9,584 to JPY11,441. Both ADR and RevPAR hit record (post 2007) highs.

This phenomenal growth seems to be backed by the growing number of international tourists. The number of international tourists has skyrocketed since Kansai International Airport started to draw the attention of LCCs. Now, more than half of passengers at international terminals at the airport are non-Japanese. Osaka is a popular tourist destination where tourists can enjoy gourmet food and great shopping. Osaka also offers easy access to and from Kyoto. Kansai Airport saw over 3.5 million international arrivals last year, becoming the first major airport in Japan which had more international arrivals than Japanese counterparts.

Universal Studios Japan might be another reason for the increase in international tourists. Full year to March 2015, it broke records for entrants – 12.7 million, a 2.2 million increase from the same period last year. The theme park has been very popular, particularly after the new area featuring Harry Potter was opened in July 2014. JPY45 billion was invested to establish the new area and the number of entrants has been increasing ever since. The park also has many shows and events featuring popular Japanese animations, in order to be “de-Hollywood” or diversify its attractions. These efforts attract multiple international guests: as many as 800,000 international guests visited the park in FY Mar 2015, a

TABLE 2 **Tokyo, Osaka, Nagoya hotel pipeline, as of June 2015**

	Tokyo	Greater Osaka	Greater Nagoya
2015	3,189	1,462	148
2016	3,209	1,066	1,192
2017	1,371	170	528
2018	1,000	387	0
TBD	780	680	911
Sub total	9,549	3,765	2,779

Source: Hoteres published on 5 June 2015, Savills Research & Consultancy

300,000 increase from the same period last year.

Investment

The hotel investment market has been active as a result of the favourable macro conditions. In particular, J-REITs and their sponsors have been strong buyers. According to transaction data provided by Real Capital Analytics (RCA), there have been 63 hotel transactions in Japan this year (to August). J-REITs, or their sponsors, have been the buyers in the case of more than 40 hotel transactions. The hotel sector is one of the best performing J-REIT sectors because equity investors also like the favourable macro story and rent structures to capture growth (hotel J-REITs typically have some variable rent components which capture the upside potential of hotel performance). Hence, hotel J-REITs are currently active in capital raising and have a strong drive to acquire more properties.

Cap rates of hotels have been compressed but are still meaningfully higher than residential properties. That said, some transactions of budget hotels in prime locations see low-4% level cap rates. Owners of hotels may enjoy a significant upside of ADR and RevPAR if leasing contracts have a large proportion of variable components related to operating performance. Some J-REITs, such as Invincible Investment Corporation, sponsored by Fortress, derive the performance

of their hotel portfolio through a variable rent structure.

New opening plans

In order to capture Japan’s growth story in the hospitality sector, many hotels, including international brands, are planning new openings in Japan. In 2014, international brands such as Aman Tokyo and Andaz Tokyo (pictured, cover page) took a foothold in Japan. Aman Tokyo is the first urban hotel among its branded hotels and resorts in the world. The Ritz Carlton also had a new opening in Kyoto in 2014, while Marriott forayed into the newly-built Abeno Harukas in Osaka, the highest building in Japan. Their operations seem to be performing well.

Some major new plans in Tokyo, such as the redevelopment of the Okura Hotel and Kioicho Prince Hotel towards the Tokyo Olympics, are in progress as well. According to Hoteres, a weekly magazine focusing on the hotel and dining business in Japan, there were 10,000 additional rooms expected to be supplied in Tokyo as of June 2015. There are 3,800 rooms expected to be added in Osaka and 2,800 in Nagoya. Amidst rising land prices and labour costs, particularly in the construction sector, some opening plans have been cancelled. It is likely to take some time until there is a sufficient supply of hotels to accommodate the skyrocketing number of tourists to big cities in Japan. To respond to high demand for hotel rooms, some companies have even begun to convert existing office buildings into budget hotels. ■

OUTLOOK

The prospects for the market

LCC's growing share of the airline market and a stable, soft Japanese yen are further fuelling the growth of international arrivals. If the current trend continues, the government will be able to achieve its target of receiving 20 million visitors this year or next year, a few years earlier than the original target of

2020. On the other hand, the supply of hotel rooms is not proportionate to the growing number of tourists, and it is likely to take some time before enough hotels are supplied. Hence, the hospitality sector in Japan is expected to perform well towards 2020, barring any unforeseen circumstances - we need to monitor the market carefully, however,

because the hospitality sector is changeable and vulnerable to major events such as natural disasters and global/regional epidemics. Also, in addition to a stock of hotels suitable for international tourists, additional services such as multi-lingual hotel staff may be urgently needed.

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