Japan - February 2021

SPOTLIGHT
Savills Research

Japan Hospitality

savills

Tough times persist

Summary

- International borders are still essentially closed to tourists, and the second half of the year saw only a small number of foreign arrivals.
- While a second state of emergency has been enacted, the Japanese government increased the "Go To" Travel campaign funding to up to a total of 2.7 trillion yen, extending the initial support provided to the industry.
- Bankruptcy rates kept low due to emergency loans will likely increase as banks re-evaluate forbearance.
- Although the second half of 2020 saw some recovery, the number of hotel nights stayed should see a decrease in early 2021 due to the state of emergency.
- As of December 2020, Hotel J-REIT ADRs were 80% of pre-COVID levels, and RevPAR was down almost by half. Japanese-style hotel (Ryokans) and resort hotels are faring better than business and city hotels.
- The spread between the unit prices of Hotel J-REITs and the TSE REIT index narrowed in the second half of 2020, implying that J-REIT investors have priced-in further recovery.
- Hotel investment volumes plummeted with few loans available, and the second half of 2020 accounted for only 13% of the yearly volume.

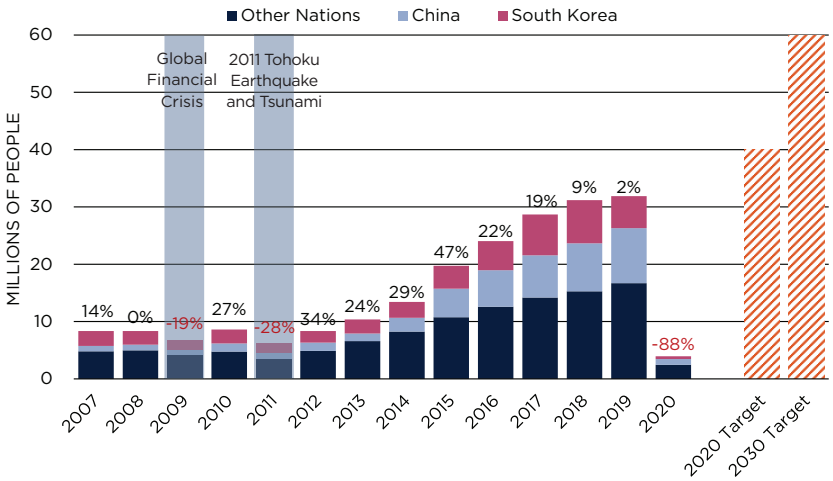
INTRODUCTION

The second half of 2020 brought only a little more hope to the hospitality sector than the first half. International borders have remained effectively closed to tourists, and as a result, the number of visitors has not seen any change from the first half of the year, with fewer than 170,000 visitors entering the country in 2H/2020. This figure is certainly not expected to see any meaningful increase while international borders are closed and is unlikely to rebound if COVID-19 cases worldwide do not subside.

The first state of emergency enacted in April 2020 devastated the domestic tourism market. In response, in July 2020 the government offered an economic lifeline to the industry in the form of the "Go To" Travel campaign, with a total of 1.1 trillion yen initially allocated to the program aimed at supporting the hospitality industry. The campaign was further bolstered with up to an additional 1.6 trillion yen, including the additional and supplementary budget for fiscal year 2020[1], possibly providing up to a 2.7 trillion yen boost in total. The stimulus helped to curtail widespread layoffs in the industry especially in regions where they would have caused extensive harm to the economy.

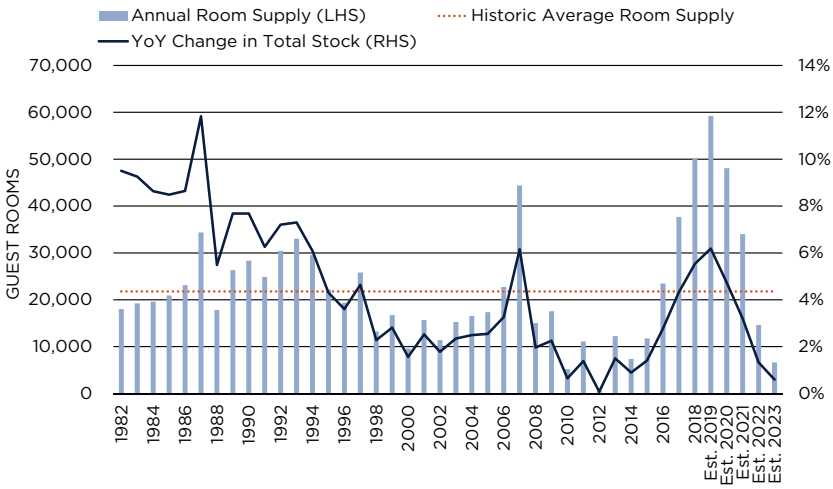
1 The Japanese 2020 fiscal year began in April 2020 and ends in March 2021.

GRAPH 1: International Arrivals and Annual Growth Rates, 2007 to 2H/2020



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

GRAPH 2: Hotel Guest Room Supply, 1982 to 2023*



Source Hoteres, the Ministry of Health, Labour and Welfare (MHLW), Savills Research & Consultancy
*As completion data provided by Hoteres is as of 5 December, total supply in 2020 includes hotels expected to be completed thereafter.

The program subsidises domestic travel for residents, and according to the Japan Tourism Agency (JTA), its usage saw the overall number of hotel stays recover to about 60% of 2019 levels as of December 2020. The recovery has extended to mainly Japanese-style hotels and resort hotels, while business hotels and city hotels have also showed some level of improvement. Unsurprisingly, these recovery rates were the most obvious in less urban prefectures, whereas prefectures like Tokyo and Osaka still had significantly lower occupancy rates compared to previous years, which was also to be expected due to the lower number of business trips.

However, as the hospitality industry seemed to be on the road to recovery, it once again entered uncertain waters as Japan was hit by a third and largest wave of COVID-19, prompting the government to introduce a second state of emergency in major prefectures this January. While this second state of emergency had a pre-determined end date of 7 February 2021, the high rates of COVID-19 hospitalisation cases have prompted its extension by an additional month and will likely keep occupancy rates low. In addition, the "Go To" campaign will be suspended across Japan until the rate of hospitalisation cases falls.

There is some hope for domestic tourism with increased funding from the "Go To" Travel campaign and extra savings from self-quarantine. Increasing bankruptcy figures and a substantially lower supply pipeline should prove favourable for operators who can weather the storm.

LODGING BANKRUPTCIES IN JAPAN

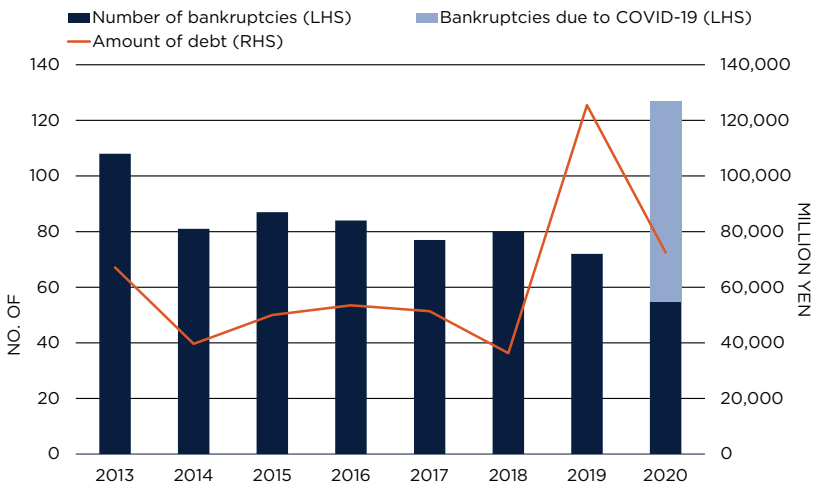
The hospitality industry has certainly not seen grimmer times in living memory. With residents being strongly recommended to avoid large gatherings and traveling unnecessarily, on top of a drastic decrease in revenue from accommodation, other revenue streams from corporate events and banqueting have also been cut. As to be expected, the number of bankruptcies has accordingly increased to an all-time high since 2011, with 127 bankruptcies reported in the lodging industry (including hotels, Japanese-style hotels, and other accommodation facilities) according to Teikoku Databank. Out of those bankruptcies, 72 were reported to have been as a direct result of COVID-19, proof that the pandemic has taken its toll on the industry.

On another hand, despite the direct negative impact that the pandemic has had on the industry and record-low occupancy rates, bankruptcy levels have remained relatively contained, albeit they are higher than previous years. The number of bankruptcies appears to have been supressed probably due to two main factors: firstly, the Japanese government has provided financial support to distressed companies, including no-interest loans backed by public credit guarantees: and secondly, the "Go To" Travel campaign gave additional spending power to domestic consumers. As of December 2020, approximately 500 billion yen of the "Go To" Travel budget had been spent and has helped to fund more than 80 million hotel stays, which marks a notable boost to the approximately 6 trillion-yen Japanese lodging market. These factors provided much-needed cash flow to hotels that might have otherwise had to declare bankruptcy.

While much of the hospitality industry has been kept afloat largely due to available financing and the boost from the "Go To" campaign, hotel demand is still a fraction of what it was previously, and because hotels run on thin profit margins, many hotels are still deep in the red. The suspension of the "Go To" campaign in combination with the prevailing COVID-19 wave signal persisting tough times for the hospitality industry, and 2021 is likely to see increasing numbers of bankruptcies given the challenging operational environment, and that moratoriums currently granted by banks will gradually be reconsidered as time passes.

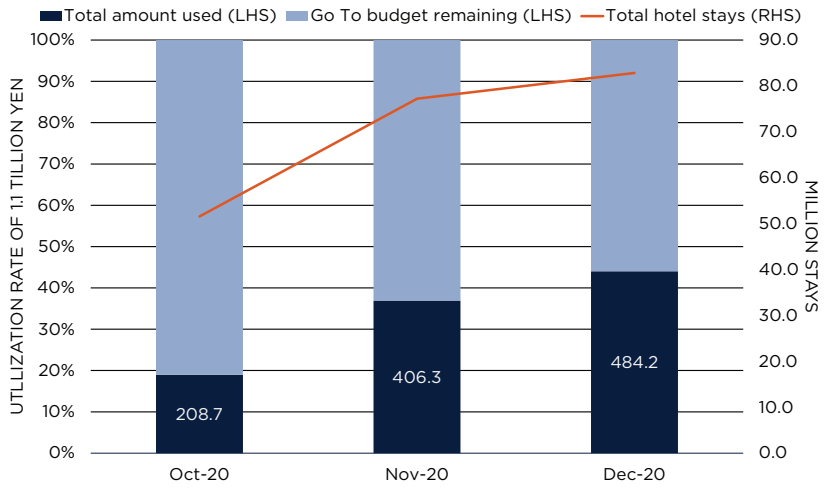
However, the "Go To" campaign offers some hope. Despite its temporary suspension, over 1.6 trillion yen of additional funding for the campaign is available until June, just before the peak travel season in summer. Hotel room supply is expected to cool significantly beyond 2020, and hotel bankruptcies are expected to increase, meaning that hotels that are able to overcome the worst of the pandemic will likely find themselves in a more advantageous position. Nonetheless, the imminent priority for hotels is to survive the ongoing downturn and hope that demand for tourism returns sooner than later.

GRAPH 3: Hotel Bankruptcies in Japan, 2013 to 2020



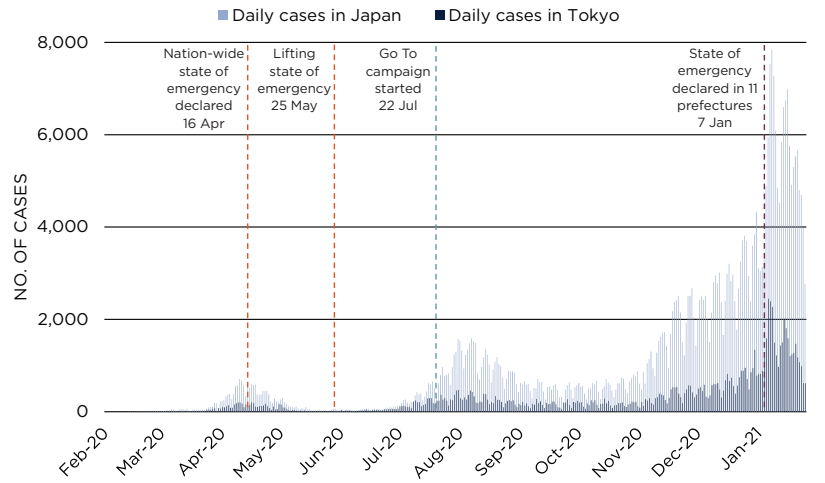
Source Teikoku Databank, Savills Research & Consultancy

GRAPH 4: "Go To" Travel Campaign Usage Based on Initial 1.1 trillion Yen Budget, October to December 2020



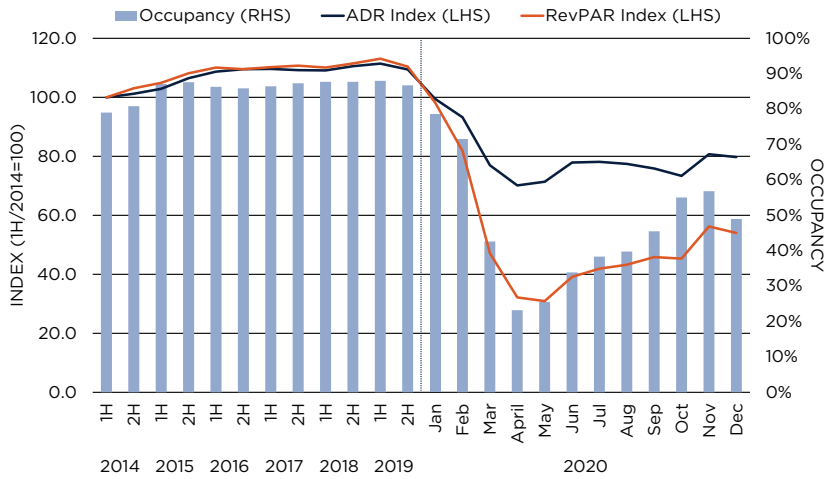
Source Japan Tourism Agency (JTA), Savills Research & Consultancy

GRAPH 5: COVID-19 Cases in Japan, February 2020 to January 2021



Source Ministry of Health, Labour and Welfare, Tokyo Metropolitan Government, Savills Research & Consultancy

GRAPH 6: Limited-service Hotel Performance, 2014 to 2020



Source J-REIT disclosures, Savills Research & Consultancy

*Note: 2014 – 2019 figures represent a trailing-twelve-month average. 2020 figures represent a simple average for ADR and RevPAR, and occupancy is calculated based on the total number of rooms each month.

HOTEL MARKET PERFORMANCE

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

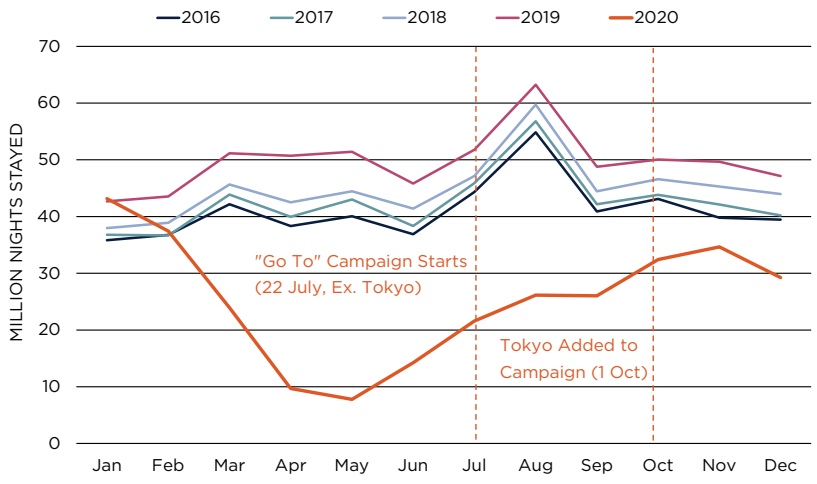
In the wake of the COVID-19 pandemic that decimated demand for hotels, rental levels have unsurprisingly followed a similar downward trend. Average daily rates (ADR) and revenue per available room (RevPAR) indices have fallen 28.5 points and 56.8 points YoY, respectively. These indices have seen an increase from their lowest points in April and May 2020, although they are still a far cry from levels of previous years. However, average rates and occupancy both dipped again in December due to the "Go To" campaign having been suspended during the year-end holiday peak period and because of the spiking number of COVID-19 cases that became increasingly apparent toward the end of 2020. Average rates and occupancy are expected to drop significantly again in early 2021 in line with the second state of emergency and the industry's seasonal low, so hotels need to continue to prepare for hard times.

While all hotels are undergoing the toughest of times, even amongst the different hotel classes, city hotels and business hotels have suffered disproportionately. The pandemic has caused many companies to move face-to-face meetings online and reduce domestic travel wherever possible, stifling demand for business and city hotels. As such, with historically low rates and occupancy levels, many operators have been desperate to find new sources of revenue to improve their bottom line. As an example, the Imperial Hotel Tokyo recently reformed part of the hotel to launch a full-service rental apartment business. There are also hotels that offer rooms to be used in the day as remote offices, some in collaboration with local governments. In addition, an increasing number of even high-end hotels are offering day-use hotel plans, where customers can use the room and hotel facilities for a few hours in the day without spending the night. Overall, these are trying times for the industry but also times where innovation thrives, which will be a crucial factor in helping hotels see the pandemic through.

2 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.

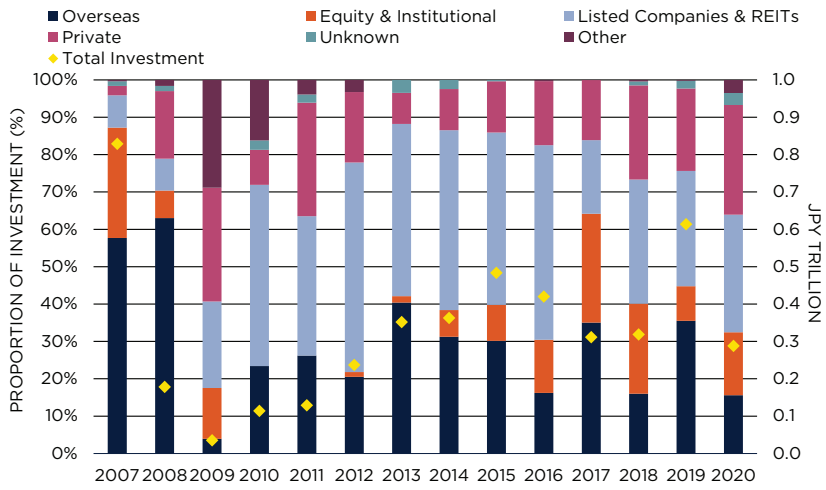
3 As of this report, Tokyo accounts for over 30% of the sample hotels while other Kanto prefectures and Kansai account for about 15% each.

GRAPH 7: Hotel Nights Stayed by Month, 2016 to 2020



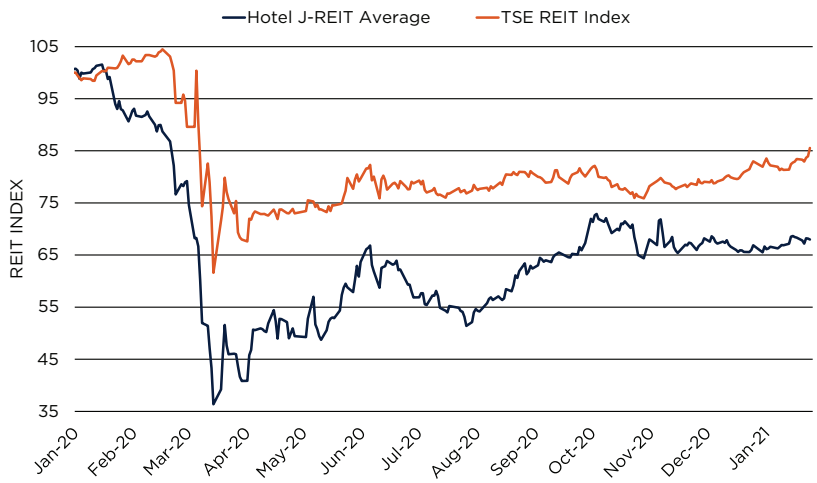
Source Japan Tourism Agency (JTA), Savills Research & Consultancy

GRAPH 8: Hospitality Sector Investment Volumes by Investor Type, 2007 to 2020



Source RCA, Savills Research & Consultancy

GRAPH 9: Hotel J-REIT Performance, 2020



Source J-REIT Disclosures, Savills Research & Consultancy

INVESTMENT

2020 was intended to be a stellar year for tourism in Japan but it has instead seen a turbulent operating performance, shaking investor sentiment, and squeezing 2H/2020 trading volumes. According to data aggregated by Real Capital Analytics (RCA), investment volumes were down 53% YoY to around 288 billion yen, following a noteworthy 2019. Furthermore, only 13% of the transaction volume occurred in 2H/2020, the lowest half-year transaction volume since 2009, dragged down by a lacklustre fourth quarter. Whilst it may look like the sector has fallen into a trough, looking at the yearly performance might go some way towards easing concerns. In this context, 2020 was only 10% shy of 2018 volumes and 8% below 2017 levels.

When the pandemic began, banks might have hoped that forbearances would be enough to usher the hospitality sector from crisis to recovery. However, with the prolonged duration of the pandemic, more distressed assets may begin to emerge in the first half of 2021. More strategic investors who have the financial wherewithal will likely capture discounted asset prices, as some have already done so. While financing is more available than a few months ago, it is still limited to properties which can demonstrate a stable performance and to parties with a good track record and a strong balance sheet.

At the onset of the pandemic in 2020, Hotel J-REIT unit prices fell more heavily than the TSE REIT index. However, the spread began to narrow from August 2020 when the "Go To" campaign started and has narrowed further since. A forecast gradual recovery appears to have already been priced into Hotel J-REIT unit prices, suggesting that there is some hope for the industry, at least from a J-REIT investor's point of view.

OUTLOOK

While the "Go To" Travel campaign has certainly served as an essential crutch for the hospitality sector and appears to have helped avert a large number of bankruptcies, the short-term prospects for the industry as a whole are not meaningfully brighter than previous quarters. International borders have been shut again after being opened for less than three months, and urban prefectures have again been placed on a state of emergency, although cases in Japan look to have hit their peak and are beginning to decline. Public support for hosting the already postponed Olympic games this year is not strong, and the games themselves are also on tenterhooks.

Nonetheless, there are positives for the industry. The first is the progress made in rolling out a COVID-19 vaccine. The Japanese

TABLE 1: Selected Investment Transactions announced In 2H/2020

PROPERTY NAME	APPROX. PRICE (JPY BIL)	PRICE PER ROOM (JPY MIL)	CAP RATE	LOCATION	BUYER
Far East Village Hotel Ariake	8.0	26	Undisclosed	Koto Ward, Tokyo	Ariake Properties TMK (SPC of Far East Hospitality Holdings)
Candeo Hotels Nagasaki	3.1	15	5.3%	Nagasaki City, Nagasaki	Daiwa House REIT
KAI Enshu	1.1	32	5.6%	Hamamatsu City, Shizuoka	Hoshino Resorts REIT

Source J-REIT disclosures, Nikkei RE, Savills Research & Consultancy

government has announced its plan to begin vaccinations in February and should expedite the entire process if the prospects of early adopters like Israel look promising. The second is the boost in domestic demand aided by expansion of the "Go To" Travel campaign budget, which should help keep afloat operators savvy enough to adapt and capture opportunities to attract its utilisation. Third, increasing bankruptcies and substantially less supply in the pipeline should prove favourable for hoteliers who manage to weather the storm. Lastly, in 2020 Japan saw all-time high savings rates with sharp falls in spending on travel and eating out, suggesting pent up demand and a greater desire to travel in the near future. Japan spends an estimated 3 trillion yen yearly on overseas travel, and some travel-starved consumers could resort to domestic travel given that overseas travel is still unfeasible.

Moreover, while 2020 was a terrible year for the hospitality industry, this was almost entirely due to external factors outside of the industry's control. Japan remains a popular tourist destination for international travellers whose numbers more than tripled from 2010 to 2019. As an example of the country's growing popularity, a survey by the China Tourism Academy ranked Japan in the top two destinations amongst Chinese tourists. To wit, the country maintains strong potential to attract inbound tourists while the longer-term prospects for domestic tourism remain promising, and there is strong potential for a rapid turnaround once the COVID storm has passed.

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