Japan - February 2023

SPOTLIGHT
*Savills Research*

# Japan Hospitality

# Despite challenges ahead, the resumption of inbound tourism has brought robust recovery


**Summary**

- Visa-free inbound tourism resumed in Japan in October 2022, and there has been a significant uptick in overseas arrivals.

- The ADR index has increased significantly due to strong demand, while occupancy has improved at a slower rate. Many hotels have prioritised raising room rates over occupancy due to labour shortages.

- There has been notable disparity in recovery between different hotel types, with resorts and luxury full-service hotels set to perform better than limited-service counterparts.

- New supply forecasts are limited over the next few years, so room rates will likely remain elevated for the time being.

- Investment volumes in 2022 in the hotel sector are expected to have notably surpassed those of 2021. More deals are expected as prices have risen close to pre-pandemic levels.

- However, the high cost of air travel, overall increasing operating costs stemming from labour shortages, utility and food price hikes in the hospitality industry, and global economic slowdown might moderate future growth.


## INTRODUCTION

Throughout 2022, Japan has transitioned toward an endemic state, and domestic tourism has made a notable recovery over the past year. In October 2022, the Japanese government resumed visa-free inbound tourism, further strengthening the prospects of the hospitality industry. Since the borders have reopened, many tourists have returned to Japan, and optimism remains high in the hospitality industry.

Japan experienced a significant uptick in foreign visitors, with nearly 1.4 million entering in December 2022. This is well over half the number seen in December 2019, although it must be noted that this recovery essentially excludes Chinese tourists. Further growth in inbound demand is expected, and JTB Corporation, the largest travel agency in Japan, predicts that around 21 million inbound entries will be made in Japan in 2023, which would equate to around a 66% recovery to the peak levels in 2019. This will offer a much-awaited boost to hotels located in inbound tourism-dependent areas, and will be a lifeline for hospitality industries more widely. Moreover, because the average economic profile of current inbound travellers appears to be much higher than the pre-pandemic average, spending by inbound tourists should see much stronger recovery. Indeed, the average per-person spending of inbound tourists in Q4/2022 was almost 25% greater than that of Q4/2019, according to Japan Travel Agency. The government has also shifted focus toward per-person spending rather than the number of inbound tourists in order to promote more sustainable tourism going forward.

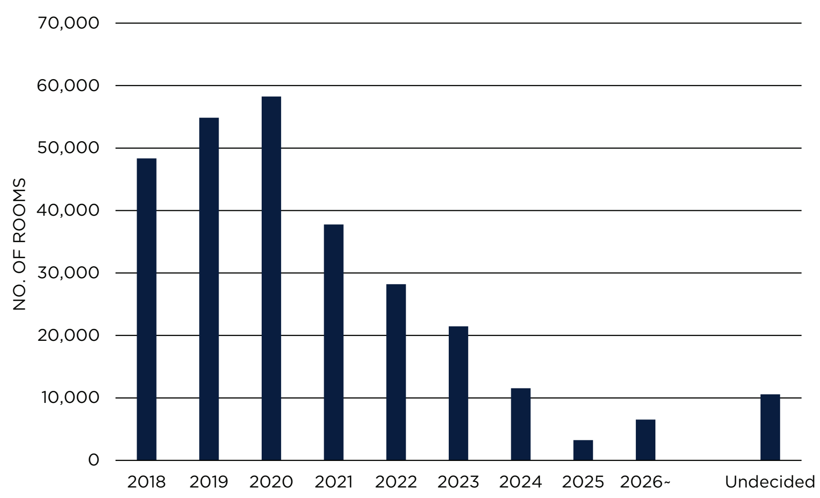
Overall, the rebound in hotel demand over the past half-year has been significant. The Average Daily Rate (ADR) has recovered completely for most hotel J-REITs, and in many cases has exceeded pre-pandemic levels by a notable amount. Occupancy still has some room for recovery, despite having increased over the past half year, but RevPAR has improved to levels exceeding pre-pandemic times.

Nonetheless, there are several hurdles facing the hospitality sector. One factor contributing to the relatively sluggish occupancy rates is the labour shortage in the hospitality industry, made even more severe by the trauma induced during the pandemic. Next, rising operating costs from utilities and food will also create more challenges for hotels. In addition, high airfares and the lack of low-cost carriers, together with the worldwide economic slowdown, are likely to make it more difficult for budget tourists that wish to come to Japan. As such, recovery within the industry is expected to be disproportionate.

## HOTEL SUPPLY

New hotel supply increased significantly in the run up to the Tokyo Olympics, and peaked in 2020. However, the hotel market saw a sharp decline thereafter, with only around 38,000 and 28,000 new rooms added to

**GRAPH 1: Hotel Guest Room Supply Forecast, 2018 to 2026**



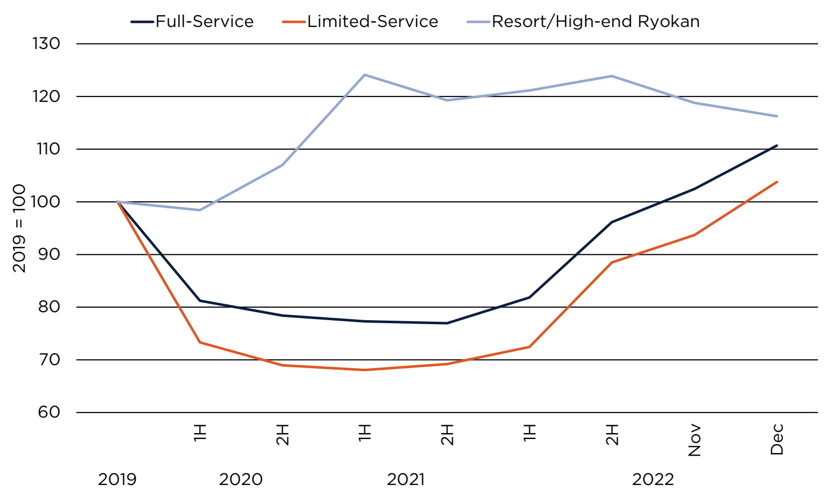

**Source** Hoteres, Savills Research & Consultancy the market in 2021 and 2022, respectively, according to data from Hoteres. As Graph 1 demonstrates, upcoming hotel supply is expected to be low in the coming years, and is therefore unlikely to disrupt the operating performance of hotels due to the moderate competition in the market.

Domestic restrictions on internal movement and business activity in Japan, as well as the havoc caused to global supply chains by the pandemic, likely contributed to delays in hotel completion. Meanwhile, labour shortages in the construction industry have pushed up construction costs and have also likely caused further delays to hotel construction. All things considered, room rates will likely remain elevated for the time being due to the limited supply.

Elsewhere, Japan has fewer luxury hotels than many other developed nations, and upcoming supply is not expected to see considerable increments. While pre-pandemic times revolved around budget tourism, the post-pandemic era will likely see some shifts toward more high-end tourism. Indeed, there is some new accommodation with room rates of over JPY1 million per night, even in regional areas. As such, some market participants have begun exploring opportunities in the luxury and high-end market due to the relative scarcity of such hotels.

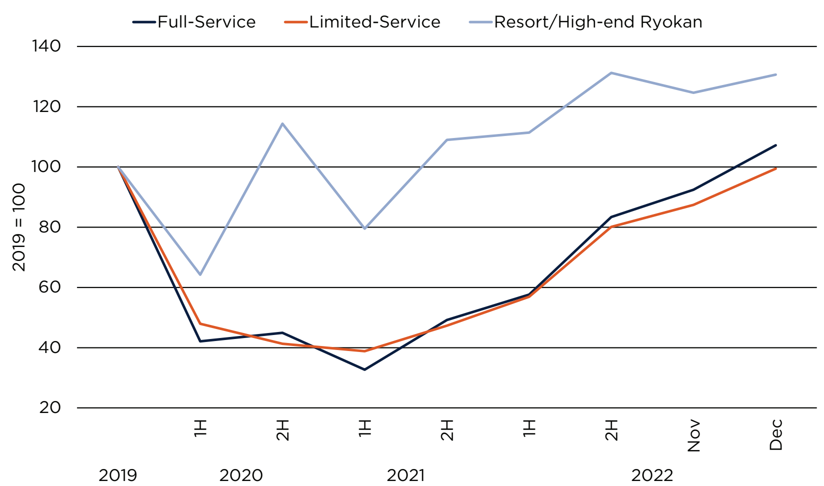
**Inbound tourism has strongly rebounded with the border reopening, and optimism is high overall. Hotel performance has improved significantly, and room rates have seen notable increments. Nonetheless, there are still hurdles facing the hospitality sector going forward, such as labour shortages, higher costs from utilities and food, and the potential impact from the global economic slowdown.**

**GRAPH 2: J-REIT ADR Performance by Hotel Type, 2019 to 2022**




**Source** J-REIT disclosures, Savills Research & Consultancy

**GRAPH 3: J-REIT RevPAR Performance by Hotel Type, 2019 to 2022**



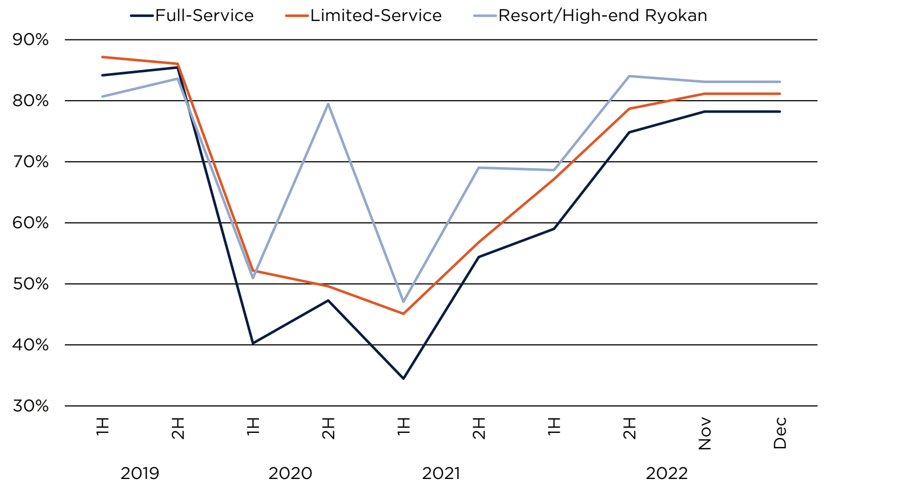

**Source** J-REIT disclosures, Savills Research & Consultancy

## COMPARISON OF HOTEL TYPES

Overall, while the hospitality industry has been recovering and is projected to continue doing so, this has not been evenly distributed amongst all hotel types. Specifically, the ADRs of resorts and high-end ryokans have significantly recovered and surpassed 2019 levels even during the pandemic, and the improving occupancy rates have also allowed RevPAR to steadily grow. Resorts and high-end ryokans have performed strongly as their target demographic of wealthy tourists has generally been less impacted by the pandemic. Many current inbound tourists into Japan are also on the relatively higher end of the income spectrum, and they have further propped up demand for resorts and higher-end accommodation.

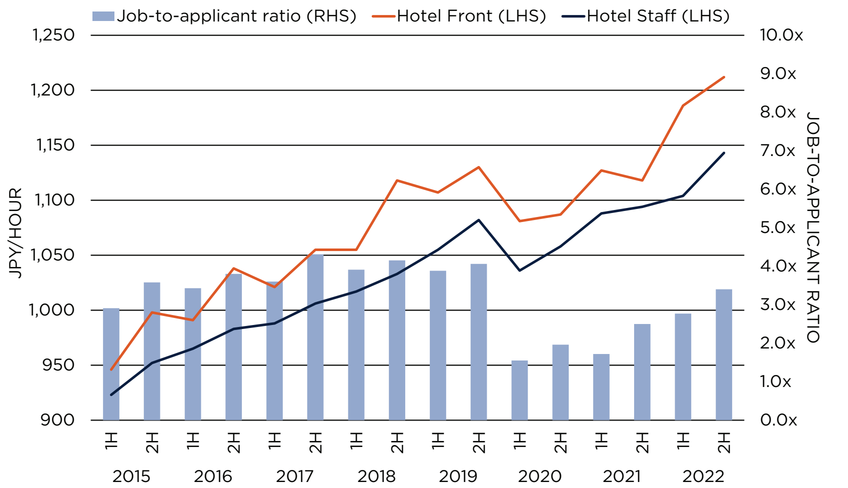
Meanwhile, full-service hotels have also improved, with ADRs in November and December surpassing 2019 levels. However, occupancy levels still lag pre-COVID times, which has slowed RevPAR recovery. It appears that many full-service hotels are pushing a strategy of increasing ADR rather

**GRAPH 4: J-REIT Occupancy by Hotel Type, 2019 to 2022**



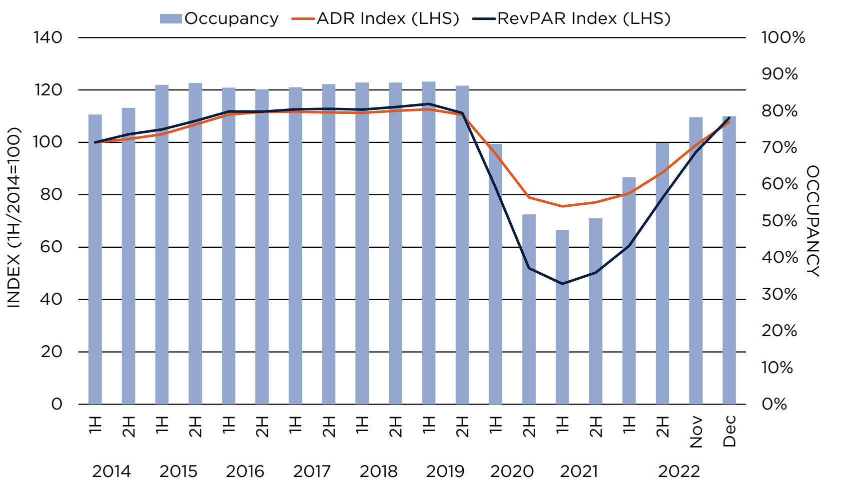

**Source** J-REIT disclosures, Savills Research & Consultancy

**GRAPH 5: Hotel Staff Wages vs. Job-to-applicant Ratio for the Hospitality Industry, 1H/2015 to 2H/2022**




**Source** Ministry of Health, Labour and Welfare, Jobs Research Center, Savills Research & Consultancy

**GRAPH 6: Limited-service Hotel Performance, 2014 to 2H/2022**




**Source** J-REIT disclosures, Savills Research & Consultancy
Note: Occupancy is calculated based on the total number of rooms each month.

than occupancy. Indeed, labour shortages are a prolific problem in the hospitality industry, and many hotels are struggling to recruit sufficient staff. Some hospitality employees may be unwilling to return to the industry unless working conditions see noticeable improvements, and the labour shortage may be exacerbated by the ageing population in Japan.

As Graph 5 demonstrates, hourly wages for hotel employees have risen to new peak levels since the brief drop in 2020, in order to attract workers. However, despite the increased wages to lure new workers, hotels have still been unable to find sufficient staff. Indeed, the hotel job-to-applicant ratio has grown from 2.8x in 1H/2022 to 3.4x in 2H/2022, demonstrating the severe shortage of labour in the industry. This labour crunch is more likely to disproportionately affect budget hotels, as their thinner profit margins will make wage increments more difficult. Nonetheless, the industry is indisputably in better shape and on track for recovery despite these challenges, and should look to improve further when Chinese tourists return.

## HOTEL MARKET PERFORMANCE

Savills tracks the performance of approximately 100 hotels owned by five J-REITs[1] 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 budget segment market trend in Japan[2].

Japan has transitioned toward an endemic state over the past year. Domestic tourism has largely returned in 2022, and inbound tourism looks set to rebound further in 2023. As expected, Graph 6 indicates that hotel J-REITs have recovered even further in 2H/2022. The ADR index increased significantly over the past half-year, and is 7.5 points higher in 2H/2022 than in 1H/2022. RevPAR index experienced an increment of 17.8 points half-year-on-half-year (HoH), and notably an increment of 28.0 points year-on-year (YoY). Furthermore, it should be noted that the performance in December has already outstripped pre-pandemic times.

Overall, occupancy levels of limited-service hotels still lag behind those of pre-pandemic times. Indeed, many operators no longer have high occupancy targets, due to labour shortages. Also, global energy price hikes have led to international travel becoming unaffordable for a large number

1 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.

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

of average households in the Asia Pacific region. Furthermore, the number of more affordable Chinese LCC flights, which played an outsized role in the pre-pandemic inbound tourism boom, is currently just a fraction of 2019 levels. This has led to notably higher airfares that look to remain throughout the year. This imposes limitations on potential mass inbound arrivals to Japan, which has prompted market participants to focus on mid-market or higher-grade hotels.

## INVESTMENT

Both the reopening of Japan's borders to visa-free inbound travel and the anticipated strong performance of domestic travel have significantly boosted the prospects of the hotel industry going into 2023. According to RCA, investment volumes in 2022 were comparable to those of 2021. However, real volumes in 2022 are expected to be much larger than those of 2021, which should be reflected once more transactions are confirmed. Overseas investors remained keen on hotel assets in Japan in 2022, with cross-border transactions accounting for 42% of total transactions.

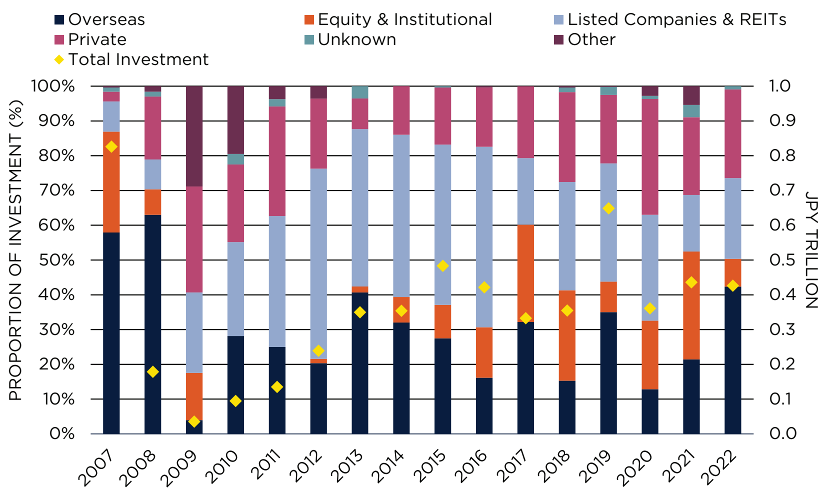
Overseas investors in particular carried out some substantial transactions over the past half-year. For instance, it was announced that Bentall GreenOak would purchase the Rihga Royal Hotel in Osaka for JPY55 billion in March, and commit an estimated JPY15 billion towards its redevelopment. Anticipating the return of overseas travellers to popular inbound hotspots, Morgan Stanley recently acquired the 333-guestroom Hotel Unizo Osaka Yodoyabashi, which will be reopened and operated by Seibu Prince Hotels Worldwide, and will be the first Prince Hotel in Osaka.

One major corporate deal announced in December 2022 was Daiwa House Industry deciding to sell its hotel operation subsidiary, Daiwa Resort, to Japan Hotel REIT Advisors, for approximately JPY56 billion.

Meanwhile, Minato-based Daisho announced the acquisition of the large Renaissance Okinawa Resort and sister property Coco Garden Resort Okinawa from Gaw Capital Partners. The properties have 473 guestrooms combined and Daisho invested between JPY25 and JPY30 billion to purchase both properties. Meanwhile, Activia Properties REIT acquired HOTEL THE FLAG Shinsaibashi for JPY14.3 billion in October.

Overall, many large transactions took place in the latter part of 2022, and there are high expectations that a rebound in inbound tourism will improve the fortunes of the hotel industry. Moreover, many anticipate that the BoJ may readjust interest rates towards spring, which could shift investor interest even further towards the hotel industry, given that hotels properties are affected significantly less by interest rate changes than tourism demand. Furthermore, many hotel owners were reluctant to sell during the pandemic, and with prices having recovered to levels only a little shy of pre-pandemic prices, we expect more significant transactions to be announced moving forward, given the

**GRAPH 7: Hospitality Sector Investment Volumes by Investor Type, 2007 to 2022**




**Source** RCA, Savills Research & Consultancy

**TABLE 1: Selected Investment Transactions Announced in 2H/2022**

| PROPERTY NAME | APPROX. PRICE (JPY BIL) | PRICE PER ROOM (JPY MIL) | CAP RATE | LOCATION | BUYER |
|---|---|---|---|---|---|
| Rihga Royal Hotel | 55.0 | 53.0 | Undisclosed | Kita Ward, Osaka | Bentall GreenOak |
| Renaissance Resort Okinawa & Coco Garden Resort Okinawa | 25.0-30.0 | 52.9-63.4 | Undisclosed | Okinawa | Daisho |
| HOTEL THE FLAG Shinsaibashi | 14.3 | 49.7 | 4.0% | Chuo Ward, Osaka | Activia Properties REIT |

**Source** J-REIT disclosures, RCA, Savills Research & Consultancy high level of demand for hotel properties and the strong capital needs from old hotel owners in need of significant capex plans.

**OUTLOOK**

Bolstered by the resumption of inbound tourism, overall, current circumstances have been robust for the hospitality industry. ADR and RevPAR levels have largely recovered, and even surpassed pre-pandemic levels in many cases, although the high room rates, on top of labour shortages and increasing operating costs from utilities and food, have hindered occupancy growth. Indeed, although January is not a peak tourism month, January 2023 figures look as good as those of December 2022, a holiday season month. In 2023, there will be room for further improvements in hotel performance with the return of some Chinese tourists. The limited supply of new hotels in upcoming years should also help to keep rates at elevated levels.

Whilst the overall mood is optimistic, the hotel sector will likely experience some bifurcation in recovery. Wealthier travellers were relatively unaffected by the pandemic and will likely continue to comprise an outsized proportion of inbound tourism demand in 2023. By contrast, budget tourism may see lukewarm growth, and some limited-service hotels in over-supplied areas may continue to struggle.

In addition, Japan's hospitality industry faces several potential hurdles going forward. The industry-wide labour shortage has prevented many hotels from operating at full capacity, making many focus on raising ADRs instead. This labour crunch will likely persist and affect hotel operations for some time. Another consequence of the high room rates is that average domestic travellers with more limited budgets might be priced out. Furthermore, the global economy is expected to experience some slowdown in 2023, which might force some potential visitors to Japan to reconsider their travel plans. Also, the current hotel performance may have been significantly boosted by domestic travel subsidy, which will expire late March.

Overall, given the promising improvement in the hotel sector, investor interest in the sector has grown over the past half-year, which has culminated in some high-profile transactions. Hotel operating performance is likely to remain strong and see further improvement, which should continue to be encouraging for market participants. More deals should be observed given that prices have risen to near pre-pandemic levels.

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