Japan - August 2022

SPOTLIGHT
Savills Research

Japan Hospitality

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Hospitality sector on track for gradual recovery

Summary

- Domestic tourism has recovered notably over the past few months and will continue to recover.
- At this stage, most of the recovery is driven by leisure travellers, whereas the prospects of MICE recovery are still uncertain.
- Border restrictions are likely to be eased soon due to the absence of nationwide elections for the next few years and the contributions that inbound tourism makes to stabilising the trade balance.
- All regions in Japan have experienced recovery, but prospects for further recovery will vary depending on inbound tourism and overall travel demand.
- Hotel occupancy has increased, while the ADR index has remained flat, implying that demand remains lukewarm.
- Investment volumes in the hotel sector are comparable to the previous year, with some notable upscale hotel transactions. Both domestic and overseas investors have been active.
- The BOJ may revise its monetary policies by next spring. The hotel sector with larger room for growth should become more attractive than other sharply priced asset classes such as logistics and residential.

INTRODUCTION

In June 2022, the Japanese government started to open its borders to tour groups. While the number of tourists entering the country is still a far cry from the tourism peak experienced in 2019, it is nonetheless a reason for the hospitality industry to be more optimistic.

The government has been highly cautious about reopening Japan's borders because of the large demographic of ageing voters that have understandably been very sensitive to potential pandemic-related risks. However, with the summer election of 2022 over, the Kishida administration now has a few years of breathing room until the next national election. Hence, the government appears more willing to expedite the revival of inbound tourism to leverage the weakened yen and stabilise the trade balance. Indeed, the coalition government with reform-minded Taro Kono as the chairman is reportedly discussing ramping up efforts to attract high-end inbound tourists, which is a promising sign of potential action.

With Japan being ranked as the top tourist destination by international entities like the World Economic Forum, and many potential tourists eager to take advantage of the weak yen, Japan appears poised for some tourism rebound as early as autumn 2022, although a full recovery is expected to be around late 2023. Indeed, even a fraction of the number of inbound tourists seen in 2019 would make a sizable difference to the hospitality industry.

In Japan, the pandemic has gradually transitioned into an endemic state, and many restrictions on travelling have been lifted. This has helped hotels to see a gentle recovery over the past few months. The Revenue Per Available Room (RevPAR) for some hotel J-REITs has been steadily recovering, and has been able to reach breakeven points even at the J-REIT level. Indeed, occupancy rates across all regions have increased, although the recovery of Average Daily Rate (ADR) has been slower.

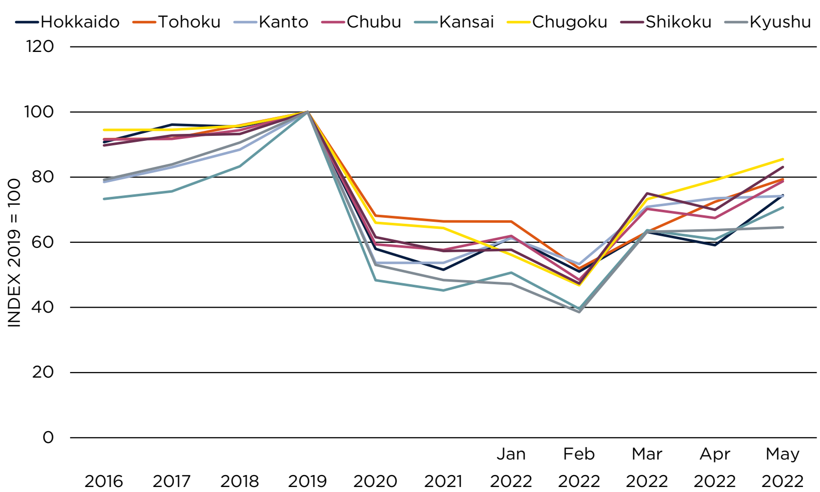
Nonetheless, summer is the peak travelling season in Japan and the high demand for travel should provide some relief to all hotels. Indeed, the soaring costs of travelling propelled by high energy prices, the weak yen, and cumbersome procedures for international travel are likely to incentivise Japanese nationals to stay domestic. In addition, business travel should also continue improving, albeit slowly. The improving prospects of the hotel industry are likely to strengthen the attention of investors.

REGIONAL ANALYSIS

The pandemic severely impacted the hospitality industry in all regions of Japan. While all regions have experienced recovery over the past two years, there is certainly some way to go before achieving a similar level of demand seen during 2019. Indeed, the number of hotel stays of all regions in 2022 are around 65-85% of 2019 levels, although it must also be noted that 2019 was the peak year for tourism in Japan, with events such as the Rugby World Cup further boosting travel demand.

Nonetheless, there is some disparity

GRAPH 1: Total Number of Hotel Stays by Region, 2016 to May 2022*



Source JTA, Savills Research & Consultancy
* The index is calculated by taking the number of hotel stays of each region in 2019 as 100. Jan – May 2022 are calculated in comparison with the monthly average of 2019.

between different regions. Notably, Kanto, Kansai, Kyushu, and Hokkaido have been underperforming due to their larger dependence on inbound tourism. These regions have seen a sizable increase in the number of international travellers over the past decade, and the increased hotel supply in response to the growth of inbound tourism may have made the actual present situation worse. At the same time, when looking at Graph 2, all regions except Kyushu have recovered close to 2019 levels of domestic tourism. Therefore, the full recovery of the hospitality sector for these regions appears to be dependent on the return of inbound tourism.

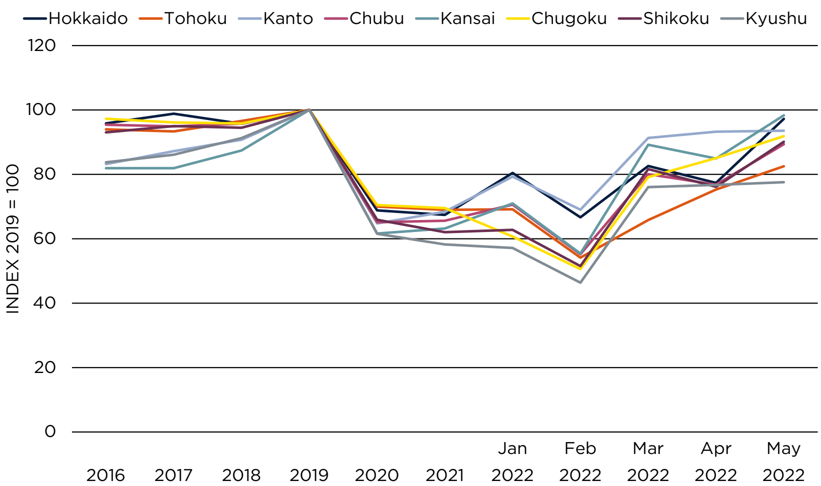
In comparison, Chubu, Tohoku, Chugoku, and Shikoku have traditionally had notably lower proportions of inbound tourists. While they are generally outperforming their inbound-dependent counterparts when looking at the total number of stays and are around 75-85% of 2019 levels, they are still underperforming when it comes to the number of hotel stays from Japanese travellers. The recovery of these regions is likely to be dependent on the recovery of the overall travel demand, perhaps especially by the elderly.

The pandemic has also caused a shift in domestic tourism trends, although this is likely to reverse gradually. For instance, all regions have seen a significant increase in tourism within the same prefecture and to nearby prefectures since the pandemic began. This trend is the most obvious in Hokkaido, likely due to the size of the prefecture and the relative distance from other regions. Trips have also generally become shorter in duration. The pandemic negatively impacted many households financially, and travellers on tighter budgets are likely to have sought more affordable options like travelling close-by, or for shorter periods of time. Going forward, however, there is likely to be greater demand for trips that are longer in duration and further away, as indicated by a recent survey by JTB.

Overall, demand is expected to keep gradually recovering across all regions as society progresses towards an endemic state, and as borders are steadily reopened. While the dichotomy between regions is likely to remain for the time being, the gap should gradually narrow as more inbound tourists are allowed into the country and economic recovery ensues.

Japan's hospitality industry has experienced encouraging recovery as domestic tourism approaches pre-pandemic levels. Japan is also expected to open its borders more to inbound tourists to capitalise on the weak yen and stabilise the trade balance. With the attention that the sector is generating, now might be the last chance to acquire assets for investors with capital and conviction for the sector.

GRAPH 2: Total Number of Hotel Stays by Japan Residents by Region 2016 to May 2022*



Source JTA, Savills Research & Consultancy

* The index is calculated by taking the number of hotel stays of each region in 2019 as 100. Jan – May 2022 are calculated in comparison with the monthly average of 2019

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 market trend in Japan[2].

As the pandemic enters an endemic stage in Japan, hotel performance has improved and there are signs that recovery is on the way. Occupancy rates have increased significantly half-year-on-half-year (HoH), indicating that more people are travelling. On the other hand, the ADR index has remained relatively flat during the pandemic, inching up slightly by 3.4 points HoH. The RevPAR index increased by 10.0 points HoH, primarily supported by the improvement in occupancy.

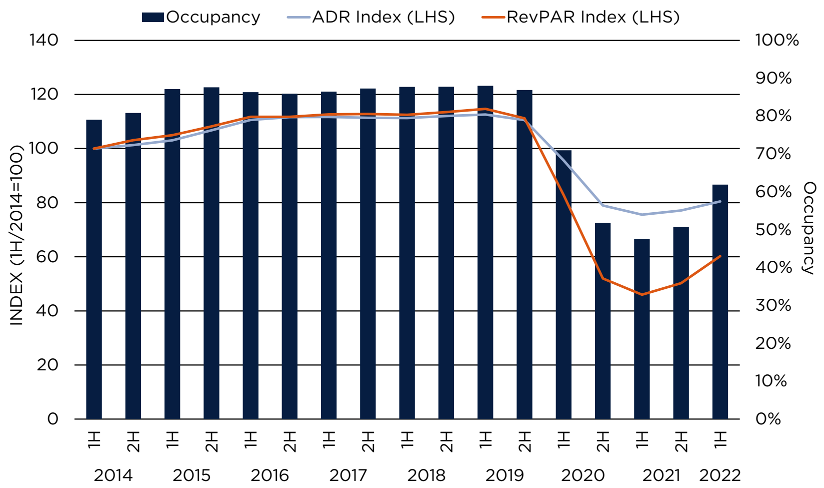
Going forward, occupancy and ADR are expected to improve further in the second half of 2022, with Japan likely to experience an uptick in both domestic and inbound demand. Indeed, the elevated costs of travelling overseas due to the weak yen and high energy prices are likely to see Japanese tourists favour travelling domestically.

GOP margins especially for budget hotel

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.

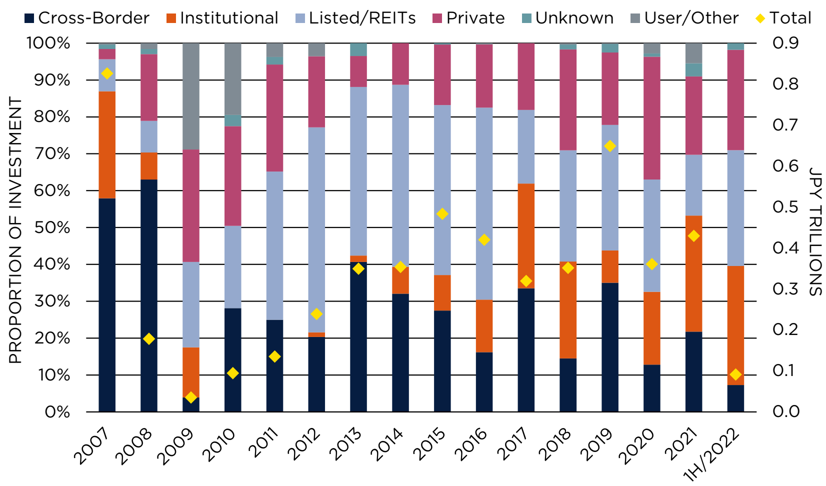
2 In this report, Tokyo accounts for over 30% of the sample hotels while other Kanto prefectures and Kansai account for about 15% each.

GRAPH 3: Limited-service Hotel Performance, 2014 to 1H/2022



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

GRAPH 4: Hospitality sector investment volumes by investor type, 2007 to 1H/2022



Source RCA, Savills Research & Consultancy

TABLE 1: Selected investment transactions announced in 1H/2022

PROPERTY NAME	APPROX. PRICE (JPY BIL)	PRICE PER ROOM (JPY MIL)	CAP RATE	LOCATION	BUYER
Seibu Portfolio	150.0	-	Undisclosed	Multiple	GIC
The Ritz Carlton Kyoto (49%)	23.0	343	3.5%	Kyoto	Sekisui House
Hoshinoya Okinawa (77.5%)	12.2	157	5.2%	Okinawa	Hoshino Resorts REIT

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

are likely to become thinner, due to the labour shortage and overall elevated costs. Hence, an increase in room rates looks inevitable. For instance, Toyoko Inn, a major budget hotel operator, is reportedly looking to focus on ADR rather than occupancy. Discounts to improve occupancy may not be that common going forward.

While the hospitality industry is expected to gradually recover, there is likely to be notable divergence in recovery. The crisis in Ukraine has driven up energy, food, and other material costs, and this cost-driven inflation has particularly impacted average households that have faced stagnant wage growth. Coupled with the reduction in business trips throughout the pandemic, this is likely to further delay the recovery of the budget hotel sector, while the market is likely to see an increase in the luxury hotel sector catered toward both international and domestic high-end tourists. Therefore, while budget hotels may still need to brace for tough times, luxury hotel performance is expected to improve, as seen from the rising room rates of prime hotels. Savills prime benchmark shows an increment of 11% for luxury room rates in July 2022 compared to the previous half-year.

INVESTMENT

Prospects look brighter for the hotel industry in 2022, with both domestic and inbound travel set for a resurgence in the second half of the year. Although transaction volumes have lagged so far, declining by 61% in 1H/2022 compared to the same period last year (Graph 4), this year has seen many large transactions. Institutional investors have been active in the market, again comprising the largest proportion of transactions so far in 2022 as in the previous year.

Both domestic and international players have been active this year. For instance, Kenedix acquired a 49% co-ownership interest in the hotel W Osaka, under the W brand of Marriott International, which features 337 guestrooms as well as restaurants, a banquet hall, and spa. Looking at international investors, KKR has been in talks with Odakyu Electric Railway over the purchase of the Hyatt Regency Tokyo hotel. Star Asia Group has also announced its investment in Greens Co. and Washington Hotel Corporation, becoming the large shareholder in these hotel operators, demonstrating the confidence in the sector.

Overall, 2022 has seen many notable transactions, with confidence in the hotel industry set to increase going forward. Furthermore, as we explain in our 2022 "Investment Strategy" report, the BOJ may revise its monetary policy by next spring. Hotel properties, which are affected significantly more by tourism demand than interest rate changes, may become more appealing to investors, especially given the current transition toward a recovery phase.

The next few months may present an opportune window for investors to acquire hotels. Banks are still generally cautious about providing loans for hotel acquisitions, and only investors with sufficient capital and grit would be able to capitalise on this opportunity. Indeed, as inbound tourism recovers and banks become more confident in providing funding, prices of hotels will only increase, and may even exceed pre-pandemic levels.

OUTLOOK

Prospects for the hospitality sector look increasingly optimistic as Japan progresses towards an endemic state. The inflated costs of travelling overseas due to the weak yen will urge many travellers to seek domestic options instead. Demand for hotels in Japan is therefore likely to steadily increase and provide greater confidence for the industry. Furthermore, with elections out of the way, and with inflationary pressures stemming from the weak yen, the government has greater incentive to expedite the reopening of borders to inbound tourists to help the trade balance, and is likely to do so soon.

All regions in Japan have seen considerable recovery over the past few months. However, the hospitality sectors of different regions are likely to see different rates of improvement depending on how recovery proceeds.

Luxury tourism is likely to keep seeing a resurgence going forward, as we have observed in other sectors. Also, the government has been making concerted efforts to attract wealthy inbound tourists, although the lower number of tourists expected from China due to its zero-COVID policy may hinder this somewhat. Meanwhile, rising inflation and stagnant wages are squeezing the budgets of average households. In addition, the recovery of business trips has been much slower. Hence, it is likely that the budget hotel sector needs more time to see the recover.

Nonetheless, border openings are limited at present, and banks are still selective about providing loans for hotel acquisitions. However, this presents a pristine opportunity to acquire hotel assets for investors with sufficient capital and conviction of recovery. Interest rates are likely to see a moderate increment by next spring, and this is likely to divert some attention away from sharply priced sectors like logistics and residential, and towards the hospitality sector with large room for growth. Overall, the hospitality sector looks on track for gradual recovery.

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