SPOTLIGHT
Savills Research

Japan Hospitality

Hotel sector continues strong performance

Summary

- The number of inbound tourists in the first half of 2024 has surpassed the same period in 2019 and is on track to reach new highs.
- ADR and RevPAR keep hitting new highs. Occupancy started to improve with extensive recruiting and training efforts, which should gain more momentum.
- Apartment hotels are relatively new to Japan but they could emerge as a viable and more affordable option for families and those travelling in larger parties.
- While popular cities in Japan face overtourism, this problem could be overcome with proper direction to attract more visitors and redirect tourist traffic to lesser-known destinations that would benefit from more tourism.
- With the optimistic outlook for the hospitality sector, investment volumes in 1H/2024 exceeded 1H/2023 by approximately 50%, and international investors accounted for half.
- The chronic labour shortage is gradually easing as the hotel industry offers higher wages and better working conditions to attract more workers, leading to an improvement in occupancy rates.

INTRODUCTION

The hospitality sector has continued to perform strongly into 2024. The number of inbound tourists has continued to hit record levels since late 2023 - the number of inbound tourists was 17.8 million in the first half of 2024, 7% greater than the same period in 2019. It should also be noted that the number of mainland Chinese tourists has not fully recovered yet, and as of the first half of 2024, they only accounted for about two thirds of the 2019 level. In addition, spending per inbound tourist in 2023 has also hit a new high, exceeding 2019 levels by 34% (Graph 5).

The Average Daily Rates (ADR) and Revenue per Available Room (RevPAR) indices have both surpassed 2019 figures, as hotels successfully leverage increased demand to achieve greater room rates. The momentum of recovery of occupancy rates appears to be tapering off after extensive recruiting and training efforts, although it takes time to overcome the persisting challenges posed by severe labour shortages, especially in resorts and remote areas. The overall positive trend, supported by sustained pent-up demand and the weak yen, is expected to continue as Japan is projected to welcome 35 million visitors in 2024, easily surpassing the previous peak in 2019.

OVERTOURISM IN JAPAN

While the surge in the number of tourists has been greatly welcomed by the hotel industry, many are raising concerns regarding overtourism. Overtourism is an issue that many tourism hotspots worldwide are dealing with. Indeed, complaints from residents will cause headaches for officials that might be pressured to take drastic measures to appease them.

Overtourism is a relatively new phenomenon in Japan - the number of inbound tourists has risen rapidly from fewer than seven million in 2009 to over 31 million in its peak year of 2019, and with 2024 on track to reach a new record level. There are countless anecdotes from popular tourist destinations that talk about the overcrowding of public transport and heritage sites, which has ultimately led to the disruption of the lives of local residents. For example, the population in Kyoto City appears to be declining as some residents relocate to escape the overcrowding. Indeed, the Japanese government's target of 60 million international visitors per year by 2030 appears to be at odds with the feasibility of making it sustainable.

At the same time, it should be recognised that this issue is primarily prevalent in only a handful of prefectures - namely Tokyo, Osaka, and Kyoto, and a few others. Furthermore, within these prefectures, only a few cities or specific areas are actually grappling with overtourism, while many others would gladly welcome more tourists. According to the Japan Tourism Agency, the number of hotel stays for both domestic and international tourists in 2024 have clearly surpassed 2019 levels in only a few prefectures, including Tokyo, Osaka, and Kyoto, while most others have recovered to only around 2019 levels (Graph 2). For international tourists, a similar picture is painted, and it appears that many areas still have significantly more room for growth in tourism. Presently, as seen from statistics of hotel stays, foreigners have a higher tendency to visit more well-known destinations that have established infrastructure to accommodate them. Indeed, in the case of less established regions, this is likely a situation where a greater supply of hotels could generate more demand. Therefore, even greater numbers of tourists should be sustainable as long as destinations of inbound tourists are well diversified, and there is sufficient infrastructure to host them in other regions.

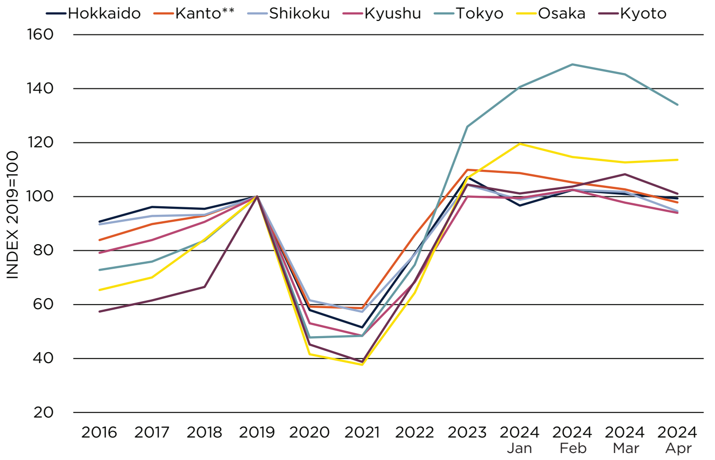
Japan has many areas that are relatively unknown to international audiences that have the potential to attract tourists. For instance, in The New York Times' annual "52 places to Travel" series, Morioka was listed as number 2 in 2023, and Yamaguchi was featured as number 3 in 2024. In fact, they lost only to major cities like London and Paris, each of which were hosting once-in-a-lifetime events like the royal coronation and the Olympics. This shows that many relatively undiscovered places in Japan could be thought of as potential top destinations, and if the right infrastructure is in place, many more travellers would visit them. To wit, if distributed accordingly, the goal of 60 million tourist arrivals by 2030 could be attained in a sustainable fashion. As a precondition, greater efforts need to be poured into encouraging local governments and organisations, especially those of tourist hotspots, to better prepare for more inbound tourists. Additional secondary traffic will be critical. Local governments need more funds to welcome tourists, which justifies appropriate charges, such as hotel taxes or higher entry fees. Overall, tourism can be a double-edged sword but should serve as an important pillar of the wider economy.

EXPLORING THE POTENTIAL OF APARTMENT HOTELS

The return of inbound tourism in Japan has greatly benefitted the hotel sector, with the ADRs of many hotels reaching record levels due to the high demand. A record number of inbound tourists have also entered the country so far since late 2023. Furthermore, according to the Japan Tourism Agency, in 2023, about

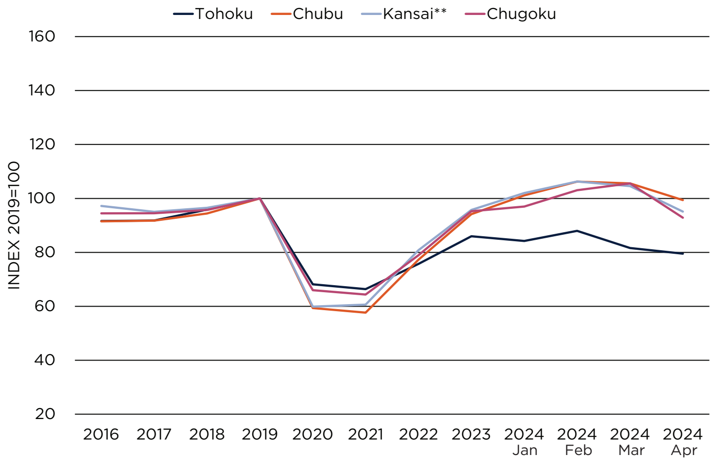
The hotel sector has continued on its upward trend, reaching new highs for ADR and RevPAR. This sustained robustness has also fuelled investment sentiment and volumes to historical highs. While overtourism is an issue in some popular areas, Japan has a wide and diverse array of locations that have not been discovered yet. More inbound tourists should be welcomed as long as they are properly distributed.

GRAPH 1: Total Number of Hotel Stays by Region, 2016 to April 2024*



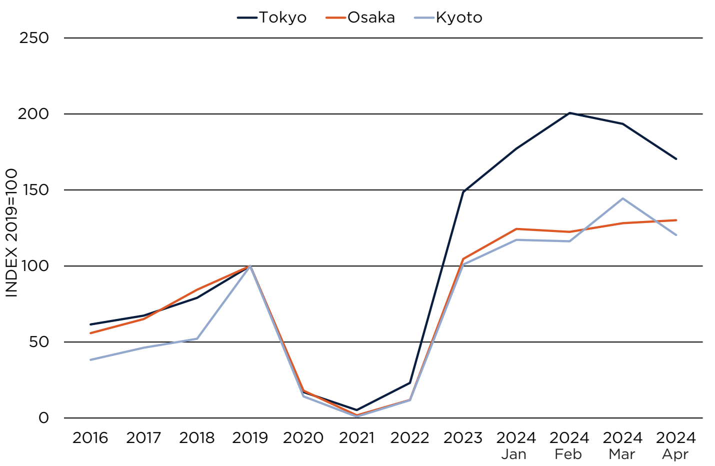
Source JTA, Savills Research & Consultancy
* Only includes regions that outperformed 2019 levels as of 2023
** Kanto excludes Tokyo

GRAPH 2: Total Number of Hotel Stays by Region, 2016 to April 2024*



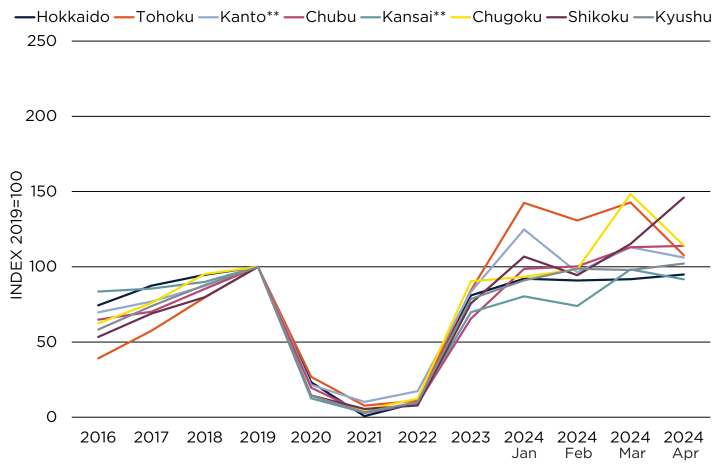
Source JTA, Savills Research & Consultancy
* Only includes regions that underperformed 2019 levels as of 2023
** Kansai excludes Osaka and Kyoto

GRAPH 3: Total Number of Hotel Stays by Foreigners by Region, 2016 to April 2024*



Source JTA, Savills Research & Consultancy
* Only includes regions that outperformed 2019 levels as of 2023

GRAPH 4: Total Number of Hotel Stays by Foreigners by Region 2016 to April 2024*



Source JTA, Savills Research & Consultancy
* Only includes regions that underperformed 2019 levels as of 2023
** Kanto excludes Tokyo and Kansai excludes Osaka and Kyoto

30% of visitors to Japan come with their families, which is the largest demographic statistically[1]. Despite the large number of family unit inbound tourists to Japan, only a small number of hotels have rooms that are able to accommodate families; most hotel rooms in Japan have only twin or double beds in a room smaller than 20 sq m, which would typically be too small to host three or more people. Furthermore, a majority of hotels with rooms larger than 40 sq m could be categorised as luxury or upper upscale, and therefore price out a large number of families, especially when considering the current market of heightened ADRs.

Therefore, apartment hotels could prove a viable alternative, offering spacious rooms catered for family units or groups at a more affordable rate. Such hotels would typically have rooms larger than 40 sq m, that can host between four and eight people. While they would not usually come with the wide range of services that luxury hotels provide, simple amenities such as a kitchen and dining area, and multiple bedrooms, could create an atmosphere of "home" and encourage longer stays. Given the low stock of such hotel rooms in the market, an ADR premium per sq m could arguably be achieved over smaller units with the proper services and marketing.

Indeed, the new supply of apartment hotels has remained relatively flat, although the rising demand for such units might change this. For example, the residential hotel business "&Here" announced the opening of "&Here TOKYO UENO" in March 2024. With 70% of the rooms above 40 sq m, the hotel is designed to cater to families and larger groups seeking longer-term stays, citing the limited number of hotels that are capable of doing so in the market, and the growing demand from families, both inbound and domestic. Room rates for a typical 40 sq m family room range between JPY40,000 and JPY60,000. The operator also aims to add a total of 1,000 such rooms in the next five years. Hence, some players in the market have already begun to fulfil this potential gap in the market.

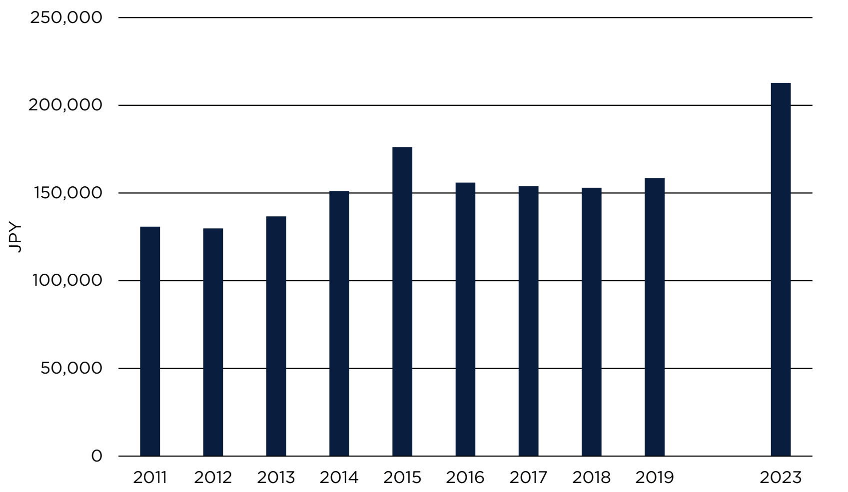
Overall, apartment hotels have the potential to cater to an underserviced part of the market; the typical size of the upper upscale and above segment but with more affordable amenities and services. A statistical majority of tourists in Japan come as families, suggesting that there is ample demand for such products in the market, some of which is being fulfilled by private lodging. Players able to overcome hurdles of identifying suitable land, rising construction costs, and labour shortages, should be able to take advantage of the current gap in the market if they are nimble enough.

HOTEL MARKET PERFORMANCE

Savills tracks the performance of approximately 100 hotels owned by four 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 budget segment market trend in Japan[3].

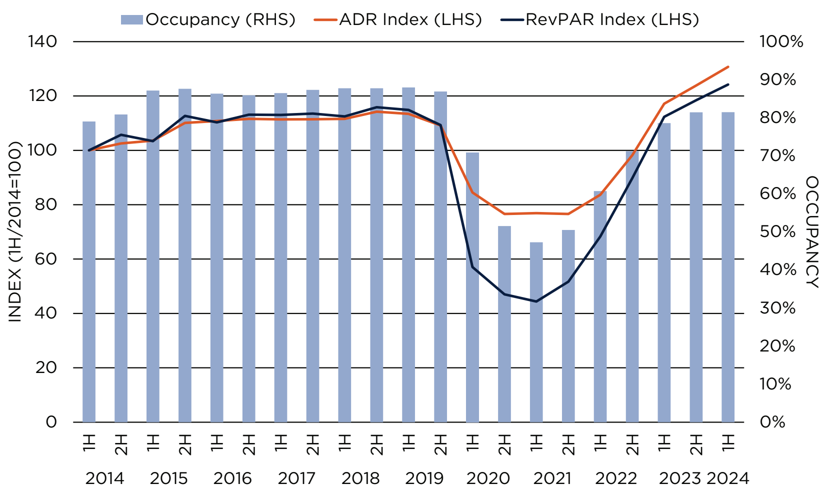
J-REIT hotels continue their growth trajectory in the first half of 2024, with notable improvements seen in the ADR and RevPAR indices. Graph 6 shows the ADR index for limited-service hotels strengthened by 6.9 percentage points (ppts) half-year-on-half-year (HoH), and 17.3ppts compared to the same period in 2019. Similarly, the RevPAR index also experienced an increase of 5.8ppts HoH, and 9.3ppts from 1H/2019. A majority of limited-service hotels posted evidently higher ADRs in 1H/2024 compared to the same period of last year. Inbound visitors in 2024 have so far surpassed pre-pandemic levels, and are forecast to continue doing so. Hotel performance is expected to continue improving, especially considering that at present, mainland Chinese inbound tourist numbers are still below pre-pandemic levels -

GRAPH 5: Travel Spending per Foreign Traveller in Japan, 2011 to 2023



Source Japan National Tourism Organization, Savills Research & Consultancy

GRAPH 6: Limited-service Hotel Performance, 2014 to 1H/2024



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

1 About 25% travel alone, 20% with friends, and 20% as a couple.

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

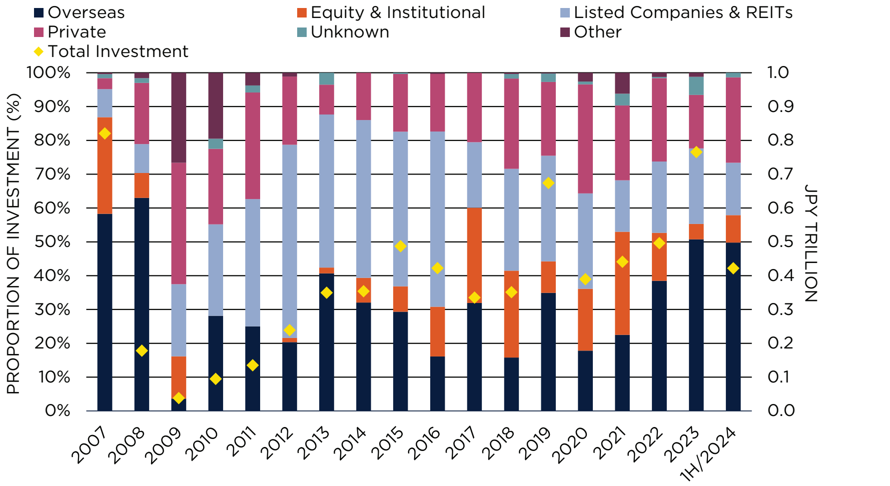
3 In this report, Tokyo accounts for over 30% of the sample hotels while other Kanto prefectures and Kansai account for about 15% each.

May 2024 inbound mainland Chinese tourist figures only at 70% of May 2019 levels.

Occupancy rates remained relatively stable at 81.5% over the past year, which is still slightly below pre-pandemic levels. While the accommodation industry has continued to suffer from the chronic labour shortage, which has been a bottleneck for occupancy rates, the situation has been gradually improving. The industry appears to attract more workers via higher wages and better work conditions. For example, Hoshino Resorts conducted an induction training camp this spring to welcome a record 750 new employees, which took place in Hokkaido, Aomori, Nagano, and Okinawa, aiming to educate the new employees about the unique appeal of each region and strengthen their ability to serve customers better. In particular, more successful recruitment has been observed in urban areas, though resorts and remote areas will likely continue to experience labour shortages to a large extent, which might necessitate more drastic measures. Given the low productivity in the hospitality industry, both relative to other industries in Japan and to the hospitality industry overseas, there should be ample room for growth, which could subsequently lead to better working conditions.

Overall, the elevated ADR trend should continue with robust demand, while improving occupancy should bolster RevPAR. According to the Japan National Tourism Organization, monthly inbound visitors exceeded three million for three consecutive months between March and May 2024, and is forecast to reach 35 million people by the end of the year, surpassing the record in 2019. As such, the hotel market is primed for further growth. Elsewhere, the recovery of banqueting and MICE has been mixed, with some hotels reporting strong performance, while others remain at a fraction of pre-pandemic levels. Performance has largely been dependent on each respective hotel's ability to maintain relationships with clients, and to the extent that each respective client was impacted by the pandemic and how much they have recovered. For instance, in July 2024, Imperial Hotel announced an upward forecast revision, citing stronger demand from inbound tourists and business travellers. Sales per person at banquets increased by 4%.

GRAPH 7: Hospitality Sector Investment Volumes by Investor Type, 2007 to 1H/2024



Source MSCI Real Capital Analytics, Savills Research & Consultancy

TABLE 1: Selected Investment Transactions Announced in 1H/2024

PROPERTY NAME	APPROX. PRICE (JPY BIL)	PRICE PER ROOM (JPY MIL)	CAP RATE	LOCATION	BUYER
Hotel Portfolio (4 properties)	56.2	-	3.6%-5.3%	Various	Japan Hotel REIT
Unizo Holdings Portfolio (14 properties)	31.5 (Preferred Equity Capital)	-	Undisclosed	Various	SPC of KKR
Omo7 Osaka	29.0	67	4.5%	Osaka	Hoshino Resorts REIT
Hommachi Garden City (Hotel portion)	21.4	133	3.6%	Osaka	BentallGreenOak
Sankei Building Portfolio (3 properties)	16.9	-	3.9%-4.6%	Various	Sankei Real Estate REIT

Source J-REIT disclosures, MSCI Real Capital Analytics, Savills Research & Consultancy

INVESTMENT

Hotel transaction volumes in 2023 exceeded JPY750 billion, eclipsing the peak recorded in 2019 and marking the highest levels since 2007. This was more than 50% higher than levels seen in 2022, and is almost 80% higher than the 10-year average between 2013 and 2022. A large proportion of transactions appear to have been carried out by international investors - approximately 50% of the transactions in 2023 and in the first half of 2024, which is the highest level since 2008.

Indeed, hotel assets have been popular among international players and are actively traded due to the dramatic recovery of the tourism sector in Japan. For instance, Sega Sammy Holdings sold all equity of its Phoenix Seagaia Resort in Miyazaki City, which comprises three accommodation facilities, two golf courses, and a convention facility on a 2.5 million sq m site, to Fortress Investment Group for a profit of JPY8.5 billion. Fosun International will sell Hoshino Resorts Tomamu, a ski resort in Hokkaido for JPY40.8 billion, having acquired it for JPY18.3 billion in 2015. Elsewhere, an SPC of KKR acquired all 14 Unizo hotels with a total of 3,600 rooms throughout Japan in April 2024 with a preferred equity capital of approximately JPY31.5 billion. Meanwhile, Sekisui House REIT sold the entire mixed-used Hommachi Garden City to BentallGreenOak, with the hotel portion of the sale property hosting The St. Regis hotel amounting to JPY21.4 billion, translating to JPY133 million per key.

Domestic investors including J-REITs have also shown increased activity in the hotel market in 1H/2024. In June 2024, Japan

Hotel REIT acquired four hotels in Japan: two in Okinawa and two in Tokyo, totalling over 1,000 rooms for JPY56.2 billion. In the same month, Hoshino Resorts REIT acquired Omo7 Osaka, a hotel in Osaka for JPY29.0 billion. Furthermore, Sankei Real Estate REIT acquired three hotels across Japan for JPY16.9 billion.

The hotel sector has been garnering strong attention from investors, evident from the steady growth of hotel transaction volumes during the pandemic and the sector should continue to witness large transactions given the optimistic outlook.

OUTLOOK

The hotel sector continues to perform well, with ADRs and RevPAR continuing to rise. Domestic travel has also largely recovered, with the number of hotel stays in most prefectures close to pre-pandemic levels, or even higher in cases. Furthermore, the number of inbound visitors has continued to hit new highs, and 2024 looks to set a new annual record. Roughly 30% of inbound visitors to Japan travel as families with three or more people, and the large number of such groups has sparked greater demand for larger hotel rooms, or apartment hotels that are able to comfortably host larger groups, of which there are relatively few in Japan at present.

With strong inbound tourist growth, there are multiple instances of overtourism in popular tourist destinations. However, only a handful of areas are presently experiencing overtourism, whereas Japan has a large number of under explored areas that could greatly benefit from more inbound tourists and should contribute to the revitalisation of depopulated areas. As long as relevant organisations are able to take proper measures to diversify tourists to different regions, Japan should be able to comfortably welcome more tourists and transform the hospitality industry into a significant sustainable economic pillar.

The hotel sector reached a new peak and has the potential to continue growing. At the same time, there are still challenges such as labour shortages, especially in resorts or remote areas further away from major cities, though recent extensive recruiting and training drives show some glimmers of hope. Increasing labour costs and inflation also bite hotel's operating margins. Nonetheless, hotels that are able to overcome these problems should greatly benefit from the strong demand present in the market.

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