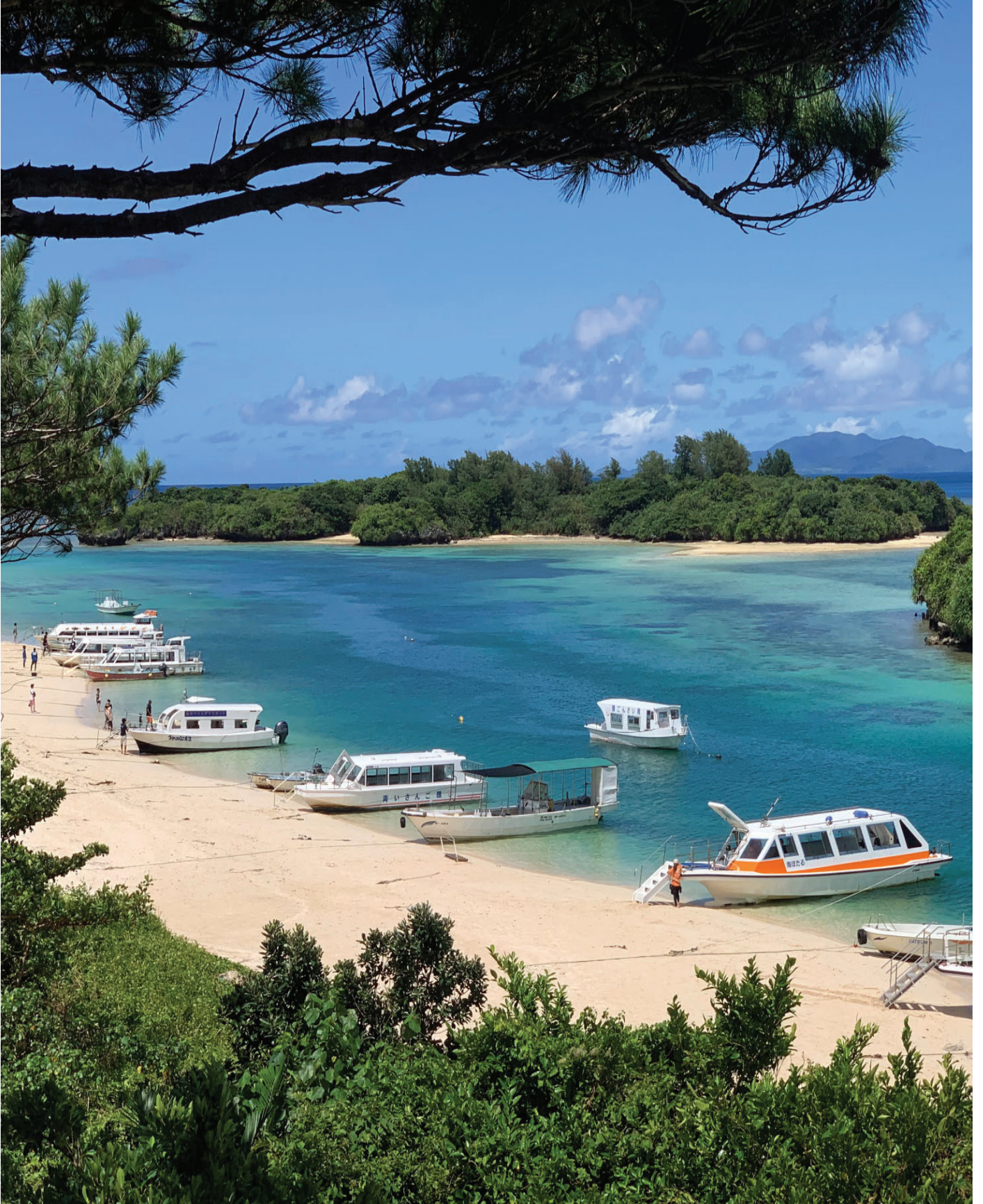


Japan - September 2020

Q
SPOTLIGHT
Savills Research

Japan Hospitality

savills



Japan's landmark year disrupted but not lost

Summary

- After eight consecutive years of growth, the number of overseas tourists is finally set to see a contraction in 2020, with only four million visitors entering the country in the first half of the year.
- Prompted by the Olympic tailwind, record supply is expected for 2020. Fortunately, new supply will cool significantly in 2021 and beyond.
- Domestic travellers accounted for 84% of overnight stays in 2019 and their spending has trended upward.
- Unemployment in Japan remains among the lowest in the world, meaning local residents still have some spending power to travel domestically.
- J-REIT price performance indicates divided sentiment within the hotel sector, with more upmarket hotel REITs outperforming those with a heavier reliance on limited-service hotels.
- Occupancy has fallen to the 20-30% range, while ADRs have compressed to less than half of what they were pre-COVID. Rural and suburban hotels are performing markedly better than their urban counterparts.
- Hotel investment volumes for 1H/2020 fell 19% YoY to around 214 billion yen. While this is a relatively modest drop considering 2019's record-high investment into the sector, volumes appear to have been supported by existing commitments entered into prior to the pandemic.

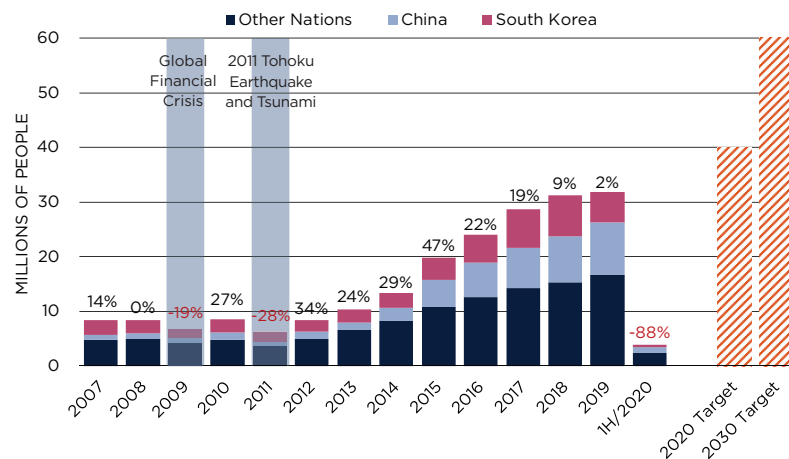
INTRODUCTION

2020 was a year of high hopes for the Japanese hospitality market. Emboldened by the Tokyo Olympics and the rapid growth of tourism since 2013, the national government had originally aimed for 40 million overseas visitors for the year. These hopes have undoubtedly been dashed by the COVID-19 pandemic, with just four million visitors entering the country in the first half of the year – a 76.3% decline over the first half of 2019. As would be expected, the vast majority of these visitors entered the country in January and February, prior to any significant border closures, with only 2,600 recorded entries in

June. Indeed, Japan is effectively as closed off as it was during the isolationist Edo Period, creating an unprecedented challenge for hoteliers.

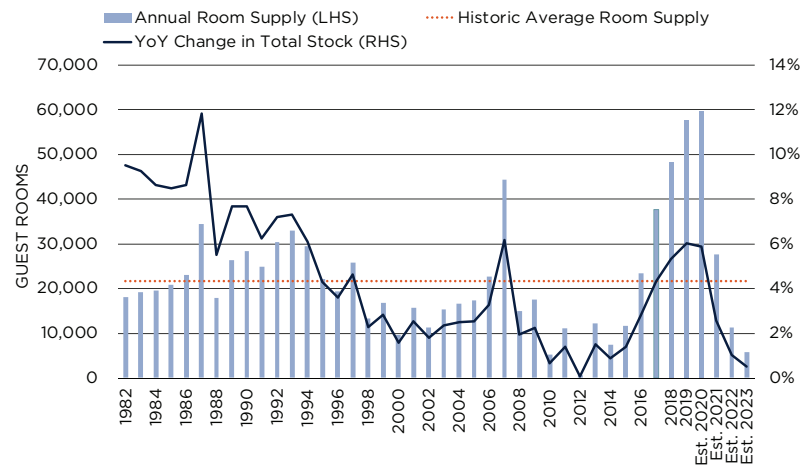
Moreover, with record room supply entering the market in 2019 and 2020, the COVID-19 crisis has arguably come at the worst possible time (Graph 2). Soaring inbound tourism and the upcoming Tokyo Olympics prompted a spate of new developments from 2017 to 2020, mostly in the budget and limited-service hotel subsectors. Fortunately, supply looks set to cool significantly in 2021 and beyond. Operators capable of weathering the storm until then may find themselves in a more

GRAPH 1: International Arrivals And Annual Growth Rates, 2007 to 1H/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 1 May, total supply in 2020 includes hotels expected to be completed thereafter.

advantageous position when the dust settles.

Indeed, despite these grim statistics, there are bright spots for the market, even in the short term. Domestic tourists accounted for 84% of overnight stays in 2019 and spending amongst this group actually grew at a higher rate than overseas tourists during the year. The country emerged from lockdown in mid-May and domestic travel has seen some recovery, providing a buffer for operators. This should be further bolstered by the government's "Go To" travel campaign implemented on 22 July, which is subsidising nationwide travel.

In the end, hoteliers are in for a long slog to get through the crisis and there have already been some casualties within the budget hotel subsector, with weakly-capitalised, newer operators such as WBF and First Cabin filing for bankruptcy. Larger, more-established players appear to be faring better and some have even doubled down on the current market. APA Group, for instance, has indicated that it would aim to more than double their hotel market share. We can therefore expect to see further consolidation in the hospitality market, which should present lower-risk opportunities to investors once the market recovers.

DOMESTIC DEMAND OFFERS A LIFELINE

Although inbound tourism has been an important catalyst for the growth of Japan's hospitality sector, domestic travellers still claim the lion's share of demand, accounting for 84% of total nights stayed in 2019. Domestic tourist spending grew by 3.6 trillion yen from 2014 to 2019, with year-on-year (YoY) growth actually outpacing that of the inbound segment in 2019 (Graph 3). That said, inbound tourists tend to stay longer and spend more money. As such, the absence

With national borders largely closed worldwide, inbound tourism to Japan has plummeted. Although overseas visitors are a key driver of growth in the hospitality sector, domestic tourism still accounts for most demand. A short-term rebalancing of assets could help mitigate some of the damage to the sector, whilst long-term inbound tourism trends could lead to opportunities for those with enough capital to weather the storm.

of inbound demand is more impactful on a per capita basis.

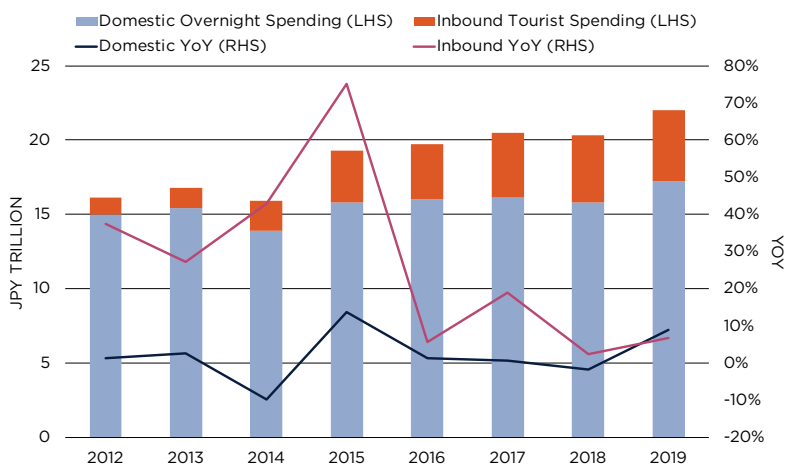
Meanwhile, the number of outbound travellers has been increasing since 2015, reaching a historic high of 20 million in 2019 (Graph 4). More than 70% of these travellers reportedly did so for leisure purposes. Given that global travel restrictions will likely remain in place for the time being, a significant portion of this demand – potentially equivalent to the total spending of inbound tourists – should be redirected towards domestic travel. Indeed, according to a survey conducted by Travelzoo Japan in May 2020, 65% of respondents indicated that they would travel domestically during the three months after Japan's soft lockdown.

Although Japan's economy has taken a significant hit through the first half of the year, the national unemployment rate is still very low compared to regional peers – even edging downward from 2.9% to 2.8% from May to June (Graph 5). The country's sound job security should give residents some financial leeway to travel domestically, in addition to supporting the relatively nascent "workcation" trend. That said, the recent uptick in new coronavirus cases may be causing some to reconsider travel plans for the time being.

Regardless, the government's "Go To" travel campaign should serve to drum up some demand. The program provides subsidies of up to 50% of the costs for domestic transportation, hotels, restaurants, tourist attractions and shopping for trips made after 22 July, with the amount capped at 20,000 yen per person per night. However, with a sudden increase of new coronavirus cases in the capital, it was announced that travel to and from Tokyo Prefecture would be ineligible for the program just days before its implementation.

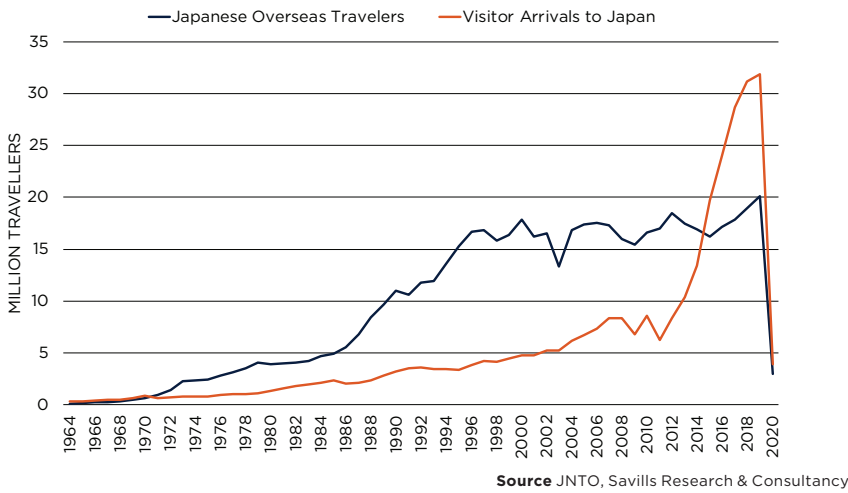
Despite the exclusion of Japan's largest market, the government has announced that two million travellers have taken advantage of the program during its first month. The campaign is scheduled to end in January 2021, or earlier if the 1.7 trillion yen allocated for the program is fully utilised before then. In the meantime, the government is discussing whether to add Tokyo to the list of eligible locations as early as September. This now appears likely given that new COVID-19 cases have begun declining in the capital. Tokyo's addition should significantly boost the impact of the campaign.

GRAPH 3: Domestic And Inbound Tourist Spending, 2012 to 2019

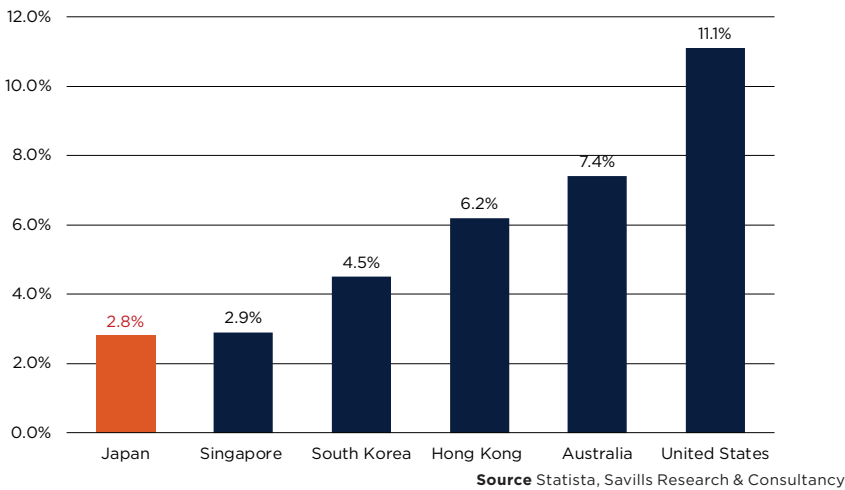


Source JTA, Savills Research & Consultancy

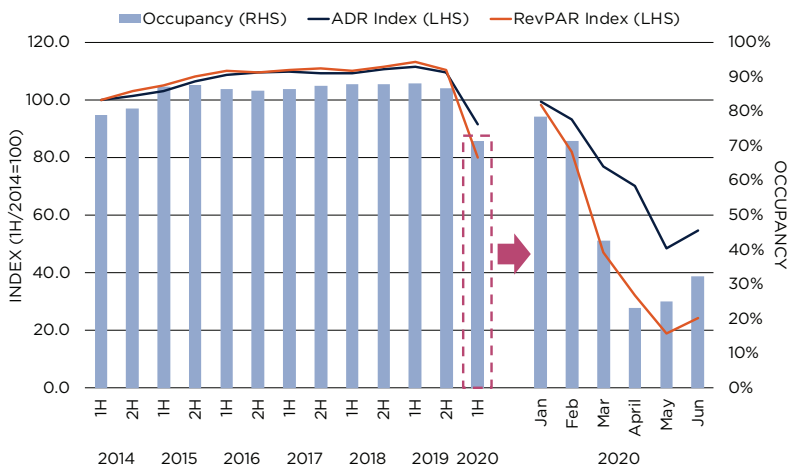
GRAPH 4: Inbound And Outbound Travel, 1964 to 2020



GRAPH 5: Regional Unemployment Rates, June 2020



GRAPH 6: Limited-service Hotel Performance, 2014 to 1H/2020



*Note: 1H/2014 - 1H/2020 figures represent a trailing-twelve-month average, whilst year-to-date figures represent a simple average for ADR and RevPAR, and a weighted average of occupancy for each month.

HOTEL MARKET PERFORMANCE

Savills tracks the performance of over 100 hotels owned by five J-REITs¹ 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 Japan².

On a trailing-twelve-month basis, our average daily rate (ADR) and revenue per available room (RevPAR) indices fell by 19.8 and 33.1 points YoY, respectively, as of 1H/2020. Over the same period, occupancy posted a decline of 16.7ppts. Of course, these performance metrics have been even more bleak in recent months. In May 2020, our ADR and RevPAR indices fell to a low of 50 points and 19 points, respectively, while occupancy bottomed out at 23% in April (Graph 6). Although these indices have grown somewhat as of June - and July appears to be on track for even better performance - the limited-service hotel subsector has undoubtedly been devastated by the pandemic. Hoteliers are indeed facing the challenge of a lifetime.

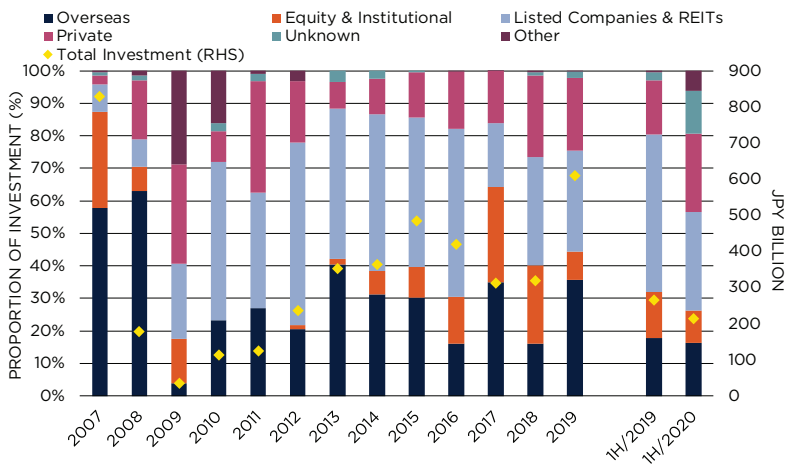
Some operators have adapted to the coronavirus disruption by offering telework vacation packages for those needing a change in scenery. Hoshino Resorts, for instance, intends to apply this and other marketing strategies to revive the struggling hotels targeted by its 20 billion yen bailout fund. Overall, famous higher-end hotels, particularly those in resort towns on the outskirts of major metropolitan areas, appear to be performing relatively well under the circumstances, with a number of such facilities posting occupancy rates exceeding 50% in July. This may be a result of the so-called “micro-tourism” trend wherein travelers choose to remain in their local areas. A hotel in Shirahama, Chiba, for instance, is rumoured to have had occupancy exceeding 80% for the month, nearly in line with average pre-COVID occupancy levels.

INVESTMENT

According to data aggregated by Real Capital Analytics (RCA), investment volumes were surprisingly robust in the first half of 2020, falling only 19% YoY to around 21.4 billion yen – a relatively modest drop, particularly when considering that 2019 saw a historically high level of investment into the sector (Graph 7). As noted previously, some major domestic players have doubled down during the pandemic. However, as buyers have generally honoured forward commitments signed prior

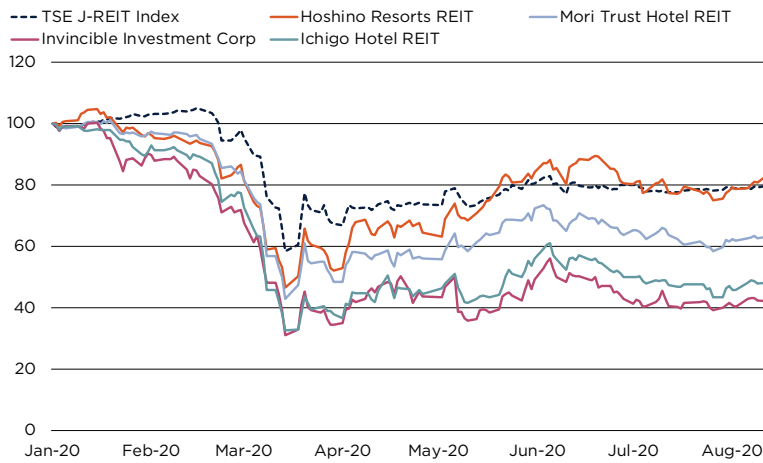
1 The five J-REITs consist of Japan Hotel REIT, Invincible Investment, Hoshino Resorts REIT, Ichigo Hotel REIT, and Mori Trust Hotel REIT. Since new samples are added when J-REITs acquire hotels, the sample size and composition may change marginally between survey periods.
2 As of this report, Tokyo accounts for over 30% of the sample hotels while other Kanto prefectures and Kansai account for about 15% each.

GRAPH 7: Hospitality Sector Investment Volumes By Investor Type, 2007 to 1H/2020



Source RCA, Savills Research & Consultancy

GRAPH 8: Hotel J-REIT Performance, 2020



Source J-REIT Disclosures, Japanese Exchange Group, Savills Research & Consultancy

to any lockdown measures or border closures, investment volumes appear to have been supported by these existing commitments rather than newly arranged deals.

Indeed, market rumour indicates that deal activity is tepid. Widespread distress has yet to manifest and, other than those trying to offload the most hard-hit budget hotels, sellers still appear to be targeting a relatively low, if any, discount on pre-COVID pricing. Further, Japan’s megabanks are now hesitant to finance hospitality deals with non-recourse loans – except in cases where most of the property’s value is derived from the land – thereby requiring investors to make a 100%-equity commitment to buy into the market. As a result, most buyers have opted to remain on the sidelines for the time being.

Distressed assets may begin to emerge later this year, however, potentially drawing out opportunistic buyers. High-credit operators with alternative business lines have enough financial leeway to support their hotel operations, allowing them to continue to pay full rents. By displaying such resiliency, these tenants should allow owners to enjoy additional cap rate compression upon the market’s recovery, opening up opportunities for the more risk-averse buyer.

Hotel J-REIT unit prices are suggesting a divergence of sentiment within the hospitality market based on both asset type and location. To wit, the year-to-date performance of Hoshino Resorts REIT and Mori Trust Hotel REIT, which are more heavily invested into upmarket hotels, have outperformed Invincible Investment Corp and Ichigo Hotel REIT, both of which are strongly-weighted towards the budget-hotel subsector (Graph 8). Hoshino REIT specifically owns more assets in resort towns and outside of city centres, where domestic tourists are more likely to frequent, including high-end ryokan. This could partly explain why its unit prices are outperforming those of Mori Trust, which, other than Hilton Odawara, holds upscale assets in major city centres.

TABLE 1: Selected J-REIT Investment Transactions Announced In 1H/2020

PROPERTY NAME	APPROX. PRICE (JPY BIL)	PRICE PER ROOM (JPY MIL)	CAP RATE	LOCATION	BUYER
Four Seasons Hotel & Hotel Residences Kyoto	49	398	Undisclosed	Kyoto City, Kyoto	GK Tigre (SPC of Tokyo Tatemono Investment Advisors)
Onyado Nono Kyoto Shichijo	24	51	Undisclosed	Kyoto City, Kyoto	hausInvest (Commerz Real)
Sotetsu Fresa Inn Shimbashi-Karasumori	8	36	3.90%	Minato, Tokyo	Undisclosed

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

OUTLOOK

Without mincing words, the short-term outlook for the hospitality sector is grim. Closed borders and local lockdowns have crushed hotel demand, causing RevPARs to decline dramatically during the first half of the year. Japan's hospitality market is of course not alone in facing these headwinds, though the timing of this crisis has been particularly problematic. The 2020 Olympics have been postponed to 2021 and an outright cancellation of the Games is certainly possible unless viable vaccines are sufficiently distributed by then.

Gloom and doom aside, some relief may be on the way. Domestic tourism is still the cornerstone of Japan's hospitality market and, with outbound travel effectively cut off, millions of local residents may instead turn their attention inward. The country is known for its dense urban clusters and, given the virus's prevalence

in such locations, it is no surprise that many are searching for an escape through micro-tourism and workcations. There are already signs of a pickup in overnight travel through July and August, particularly in rural areas on the outskirts of Tokyo. Hoteliers who can adapt and capture this new type of demand will have a key lifeline guiding them through the pandemic. As for the longer-term, whilst significant roadblocks including scandals and local opposition persist, and depending upon the world's post-pandemic recovery, the push for Integrated Resorts (IR) in Osaka and other candidate regions might gain more traction as a much-needed boost for Japan's economy, especially in regional cities.

Indeed, Japan's landmark year may have been disrupted, but this should be seen as more of a temporary setback than as a sign of inherent weakness. The 2019 Rugby World Cup, for instance, was widely hailed as a success. A survey

released by EY Japan reveals that around 60% of all international spectators visited the country for the first time, and about 75% of that group stated that they "absolutely want to come to [Japan] again in the future". It is clear that the country has significant potential to attract more tourists – only lacking a platform through which to engage with them.

An optimistic scenario would see the Tokyo Olympics held just in time to celebrate the world's liberation from the grip of COVID-19, making the event all the more important. This, unfortunately, appears to be a rather tenuous hope at present. Regardless of what happens in 2021, the travel industry, with local and national government support, will need to adapt and continue their efforts to strengthen Japan's appeal into the 2020s and beyond.



For more information about this report, please contact us

Savills Japan

Christian Mancini
CEO, Asia Pacific
(Ex. Greater China)
+81 3 6777 5150
cmancini@savills.co.jp

Savills Hotels

Raymond Clement
Managing Director,
Asia Pacific
+65 6415 7570
rclement@savills.com.sg

Savills Research

Tetsuya Kaneko
Director, Head of Research
& Consultancy, Japan
+81 3 6777 5192
tkaneko@savills.co.jp

Simon Smith
Senior Director,
Asia Pacific
+852 2842 4573
ssmith@savills.com.hk

Tomotsugu Ichikawa
Director, Japan
+81 3 6777 5184
toichikawa@savills.co.jp

Matthew D'Elia
Manager, Research &
Consultancy, Japan
+81 3 6777 5179
mdelia@savills.co.jp