Savills World Research
Japan

Spotlight
Japan hospitality

April 2016

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"Japan continues to see robust growth in inbound tourism. This growth should maintain its forward momentum and fuel a strong performance in the hospitality sector this year, despite global economic uncertainty. Tourism growth in Osaka has been especially notable."

Robust momentum in international visitors

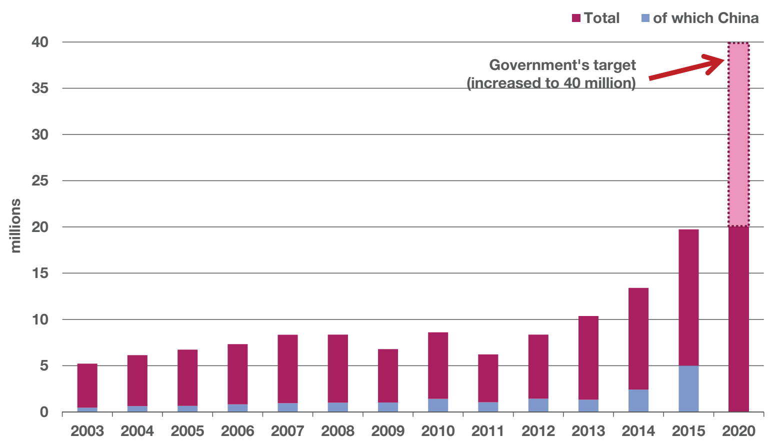
According to the Japan National Tourism Organization (JNTO), almost 20 million international tourists visited Japan in 2015, a record number. This is a 47% increase compared with last year. Also, for the first time in 45 years, 2015 saw more inbound tourists than outgoing Japanese travellers. January and February saw 1.9 million inbound tourists each, a 52% and 36% increase against the same months last year, showing strong momentum into 2016.

The Abe administration has already almost achieved its previous goal of 20 million visitors by 2020 and so this past December, the government raised its goal to 30 million by 2020. In late March, the government announced a further increase of its goal to 40 million annual tourists by 2020 and 60 million by 2030. Savills believes that the 2020 target is possible provided several conditions are satisfied, namely further visa relaxation, a continued soft currency, and infrastructure improvement such as modernizing traditional inns in outlying regions. Japan has strong potential as a tourist destination, which we will discuss in more detail in this report. The country can achieve 40 million inbound tourists in 2020 by maintaining an annual tourism growth rate of 15%.

Asian tourists have been dominant among international visitors to Japan.

GRAPH 1

International arrivals to Japan, 2003–2020



Source: JNTO, Savills Research & Consultancy

SUMMARY

- Almost 20 million international tourists visited Japan in 2015, a record number. This is a 47% increase compared with last year.

- The occupancy rate of hotels in Japan stood at 83.7% during 2015, and has hovered above 80% since 2013. Average daily rate (ADR) and revenue per available room (RevPAR) have recovered significantly. However, there remains significant potential to boost revenues, especially in US$ terms.

- In terms of the hotel supply pipeline, developers planned to add an additional 45,000 rooms nationwide as of December 2015, more than at any point in the past decade.

- Hotel development is expanding outside Tokyo to capture more inbound tourists visiting regional destinations. Well-regarded international brands are also getting involved.

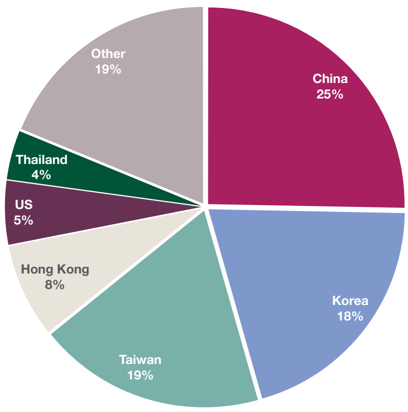
- Transaction volumes remain high, and J-REITs and their sponsors remain the major players in the market. Cap rates have been compressing because of the high demand.

- Savills expects the number of international arrivals to continue to increase considering the range of attractions available, in particular for Asian tourists, although a stronger yen and economic uncertainty in China may moderate the rate of growth.

Chinese, Korean, and Taiwanese travellers alone accounted for 65% of Japan's total inbound tourists in 2015. The growth of Chinese tourists has been especially notable. The number of Chinese tourists visiting Japan doubled from 1.3 million in 2013 to 2.4 million in 2014, and then more than doubled again to 5.0 million in 2015. Some observers are concerned about the sustainability of these figures because the Chinese economy has shown signs of a slowdown. However, January and February 2016 each saw 0.5 million Chinese tourists, a whopping 110% and 39% increase

GRAPH 2

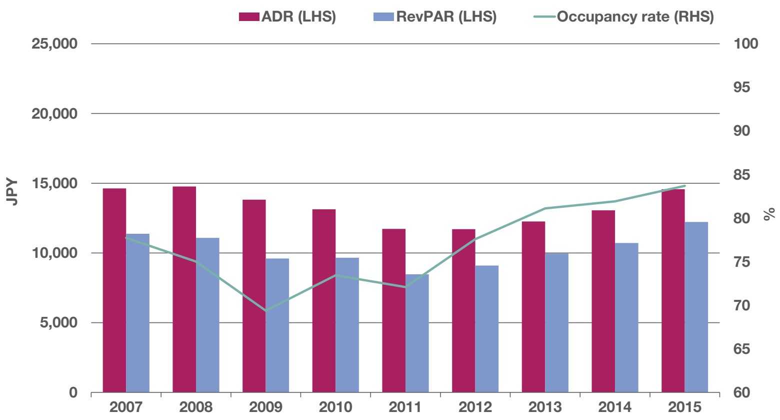
Breakdown of inbound tourists by nationality, 2015



Source: JNTO, Savills Research & Consultancy

GRAPH 3

Japan hotel performance, 2007–2015



Source: STR Global, Savills Research & Consultancy

GRAPH 4

ADR, occupancy rate, RevPAR of large cities in the world, 2015

Source: STR Global, Savills Research & Consultancy
*Numbers in parentheses show RevPAR

against the same months last year. The depreciation of the RMB may negatively affect the growth rate, but baseline figures should continue to increase into the future.

Japan hotel market

The hotel market in Japan continued to perform strongly, thanks to burgeoning international tourism. The occupancy rate stood at 83.7% during 2015, and has hovered above 80% since 2013. Average daily rate (ADR) and revenue per available room (RevPAR) have recovered significantly as well. The ADR for 2015 was JPY14,576, 11.6% higher than the 2014 figure but still slightly lower than the 2007 number. RevPAR during 2015 was JPY12,218, 14.0% higher than the 2014 figure and exceeding the 2007 level, thanks to a much higher occupancy rate. Positive market conditions are likely to further spur improvement of both ADR and RevPAR and we are expecting both indicators to hit a 10 year high in the near future.

Even with improving ADR, room rates in Tokyo (ADR: US$151, 2015) and Osaka (US$132, the same period) are still attractive, especially in US$ terms, partly thanks to a relatively soft yen. Paris, New York, London, and Hong Kong saw higher ADRs of US$286, US$256, US$218 and US$210 respectively during the same period. This implies that Japanese cities have significant potential to boost their ADRs. In addition, the occupancy rates in Tokyo (86.7%, 2015) and Osaka (90.8%, the same period) are the highest among the cities' peers: Paris (76.3%), New York (84.4%), London (81.9%), and Hong Kong (83.4%). Given the very high occupancy rates, hotel operators in Japan remain well positioned to increase ADR and RevPAR.

Tokyo hotel market

The Tokyo hotel market is also strong and the occupancy rate has hovered over 86% since 2013. ADR and RevPAR figures have recovered but there is still some room for improvement in order to hit 2008 highs. ADR during 2015 was JPY18,225, 9.4% up from the 2014 figure, but still 14.4% lower than its 2008 level. RevPAR during the same period was JPY15,829 yen, only 2.0% lower than its 2008 level because of a higher occupancy rate (86.7% during 2015 against 75.6% during 2008).

Considering the robust conditions in the Tokyo hotel market, and ADR still lagging internationally, we expect ADR and RevPAR to further increase in Tokyo even considering the conservative nature of Japanese business culture.

Osaka hotel market

The Osaka hotel market has recently seen phenomneal growth. The annual occupancy rate has remained over 80% since 2012 and reached 90.8% in 2015. ADR and RevPAR showed robust two-digit growth in both 2014 and 2015. ADR stood at JPY15,987 during 2015, a 22.8% increase against 2014. RevPAR during 2015 was JPY14,536, a powerful 27.2% improvement over the 2014 figure. Both ADR and RevPAR hit new post-2007 highs.

This phenomenal growth seems to be driven by the growing number of international tourists as overseas travel through Kansai International Airport has skyrocketed. The airport serviced 16.3 million passengers at international terminals in 2015, a 24% increase compared with 2014. In 2015, international passengers exceeded 10 million, an historical high, while take-offs and landings increased by 20% in 2015 thanks to additional flights from Asia.

This is in part because the airport is a hub for low cost carriers (LCCs) in Japan – as many as 17 LLCs operate at the airport. Additionally, approximately 25% of all flights at Kansai are operated by LCCs vs. about 10% for the rest of the country. In April 2016 the government will privatise the airport and hand management over to Orix, a Japanese financial conglomerate, and VINCI, a French airport operator. Both are experienced institutions and the airport may further strengthen its competitiveness by leveraging the expertise of its new private owners.

Universal Studios Japan in Osaka is a big draw for international tourists and the popular amusement park is likely to break last year's record of 12.7 million entrants by another one million in its fiscal year end reporting in March 2016. The number of inbound tourists to the park is said to have increased by 70-80% over the same period, hitting 1 million for the first time. A new attraction featuring Harry Potter has spurred the explosive growth of entrants, and the park's Halloween event is especially popular. Universal Studios Japan has recently changed hands from Goldman Sachs, a US bank, to Comcast, a US media group. Jean-Louis Bonnier, the current CFO of Universal Park and Resorts, will become the new CEO of Universal Studios Japan and analysts are eager to see whether he can maintain the park's robust momentum.

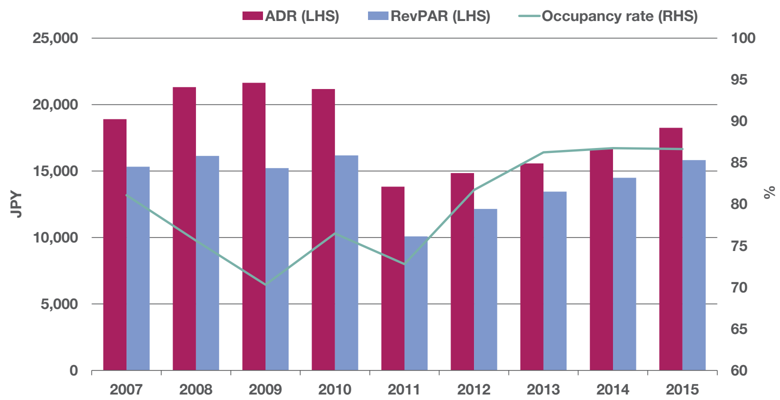
Given a strong focus on LCCs at Kansai International Airport, great local tourist attractions, and excellent access to Kyoto, Osaka is likely to continue attracting tourists from overseas and from emerging Asia in particular.

Hotel pipeline and regional expansion

As of December 2015, developers were planning to add an additional 45,000 hotel rooms nationwide in order to capture robust inbound demand. This planned expansion is greater than at any point in the past decade. The capacity will take some time to materialize, but we have written about the lack of hotel room supply in the past and see this uptick as a positive sign that developers are correctly moving to pre-empt the forthcoming rise in demand.

GRAPH 5

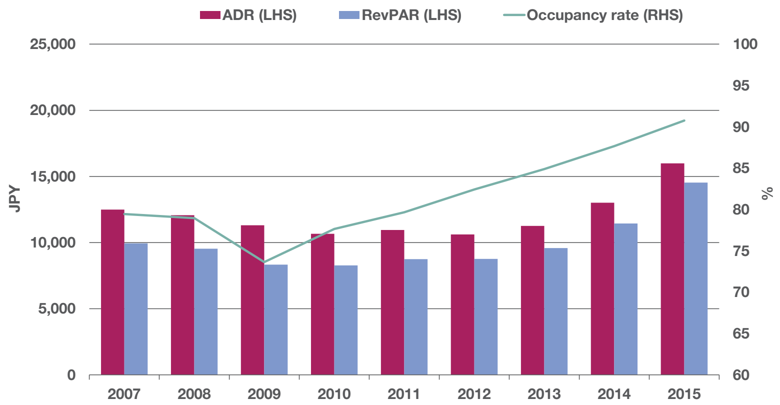
Tokyo hotel performance, 2007-2015



Source: STR Global, Savills Research & Consultancy

GRAPH 6

Osaka hotel performance, 2007-2015



Source: STR Global, Savills Research & Consultancy

Because many repeat tourists are venturing off the beaten track outside of Tokyo and Osaka, and hotels in these two major cities are almost full, Japan's regional markets are expected to see more inbound tourists. In response to this trend, a large number of hotels are expected to be developed in the regions including international hotel brands. This trend is supported by data published by the government. According to the Japan Tourism Agency, 5 out of 47 prefectures doubled the total number of stays (the number of tourists multiplied by the number of stays) by international tourists, while more than half of the 47 prefectures show over 50% growth during 2015. Also, 27 state-managed airports have generated profits for the first time in the last 5 years.

GRAPH 7

Planned new hotel rooms, Jun 2004 - Dec 2015

Source: Hoteres, 4 December 2015, Savills Research & Consultancy

In February 2016, Marriott International, Inc. and Mori Trust Group, a Japanese property conglomerate, announced the signing and rebranding of five Laforet hotels in Japan under the iconic Marriott Hotels brand name. This agreement will double the footprint of the flagship Marriott Hotels brand in Japan. Over the next two years, Mori Trust Group will renovate five existing Laforet properties totalling almost 840 rooms and rebrand them as Marriott Hotels. The five rebranded hotels – Lake Biwa Marriott Hotel (formerly Laforet Biwako), Nanki-Shirahama Marriott Hotel (formerly Laforet Nanki-Shirahama), Fuji Marriott Hotel (formerly Laforet Yamanakako), Izu Marriott Hotel Shuzenji (formerly Laforet Shuzenji), and Karuizawa Marriott Hotel (formerly Laforet Naka-Karuizawa) – are all located in scenic regional destinations. They are part of a large-scale hotel renovation plan announced by Mori Trust Group in October 2015 and represent an investment of approximately 16 billion yen. Mori Trust has multiple hotels across Japan, including Suiran in Kyoto (cover photo), a Luxury Collection Hotel, the highest grade band by Starwood Group.

In March 2016, the same two parties announced a plan to open the JW Marriott Hotel Nara in the spring of 2020. The new hotel will mark the JW Marriott brand's debut in Japan, Nara's first luxury property, and the continuation of a successful partnership between the two companies. Marriott International will operate the hotel under a long-term management agreement with Mori Trust Group. The new property will be located in the capital city of Nara, known for its traditional Japanese history and culture. Located next to Osaka, Nara is home to many of the country's oldest surviving palaces, temples, and shrines, including several UNESCO world heritage properties. It is worth noting that Nara prefecture has the largest number of UNESCO heritage properties in Japan.

Further growth potential

We expect continued strong increases in the number of international arrivals. A stronger yen and economic uncertainty in China may moderate the rate of growth, but headline numbers should remain strong and we anticipate that the government will meet its new target of 40 million annual visitors by 2020. However, to achieve

TABLE 1

Planned new hotel rooms, Dec 2015

	Tokyo	Greater Osaka	Greater Nagoya	Greater Tokyo	Okinawa	Other	Total
2015	1,218	90	0	207	0	78	1,593
2016	4,383	2,286	2,030	2,139	770	5,318	16,926
2017	3,611	2,612	1,566	1,980	1,177	3,551	14,497
2018	1,300	201	0	0	250	72	1,823
2019	200	0	0	2,400	450	0	3,050
TBD	452	654	911	1,124	2,485	1,049	6,675
Sub total	**11,164**	**5,843**	**4,507**	**7,850**	**5,132**	**10,068**	**44,564**

Source: Hoteres, 4 December 2015, Savills Research & Consultancy this number, current momentum must continue and the government also needs to commit to promoting tourism in outlying regions. On the demand side, Japan's plethora of tourist attractions, rich cultural heritage, world-class dining, and popular theme parks make it an attractive destination for Asia's burgeoning middle class. On the supply side, recent bottlenecks will ease as government initiatives and private investment boost capacity to help absorb this influx of foreign visitors.

Demand for tourism will continue to increase, especially among travellers from Asia. A variety of surveys consistently rank Japan in the top three international destinations for Chinese tourists, making Japan well-situated to benefit from Chinese growth over the near and long term. Arrivals from Indonesia, Vietnam, and the Philippines will also remain strong after the Japanese government eased visa requirements in mid 2014.

TABLE 2

Number of UNESCO properties by country, North and South East Asia

	World heritage sites
China	48
Japan	19
Australia	19
South Korea	12
Viet Nam	8
Indonesia	8
Philippines	6
Thailand	5

Source: UNESCO

We see potential for further growth as inbound tourists journey beyond Tokyo and Osaka to explore Japan's additional sightseeing destinations. First, Japan boasts 19 UNESCO world heritage properties spread across the country, ranking second in North and South East Asia after China. Second, Japan had three of the five most visited theme parks in the world in 2014, according to the Themed Entertainment Association.

TABLE 3

Number of visitors to theme parks in 2014

Rank	Park	Location	%change	Million visitors	
				2013	2014
1	Magic Kingdom at Walt Disney World	Lake Buena Vista, Florida	4.0	18.6	19.3
2	Tokyo DisneyLand	Tokyo, Japan	0.5	17.2	17.3
3	Disneyland	Anaheim, California	3.5	16.2	16.8
4	Tokyo Disney Sea	Tokyo, Japan	0.1	14.1	14.4
5	Universal Studios Japan	Osaka, Japan	16.8	10.1	11.8
6	Epcot at Walt Disney World	Lake Buena Vista, Florida	2.0	11.2	11.5
7	Disney's Animal Kingdom	Lake Buena Vista, Florida	2.0	10.2	10.4
8	Disney's Hollywood Studios	Lake Buena Vista, Florida	2.0	10.1	10.3
9	Disneyland park at Disneyland Paris	Marne-La-Vallee, France	-4.7	10.4	9.9
10	Disney's CA Adventure	Anaheim, California	3.0	8.5	8.8
11	Universal Studios	Universal Orlando, Florida	17.0	7.1	8.3
12	Island of Adventure	Universal Orlando, Florida	0.0	8.1	8.1
13	Ocean Park	Hong Kong	4.2	7.5	7.8
14	Lotte World	Seoul, South Korea	2.8	7.4	7.6
15	Hong Kong Disneyland	Hong Kong	1.4	7.4	7.5
16	Everland	Gyeonggi-Do, South Korea	1.1	7.3	7.4
17	Universal Studios Hollywood	Universal City, California	11.0	6.1	6.8
18	Songcheng Park	Hangzhou, China	38.3	4.2	5.8
19	Nagashima Spaland	Kuwana, Japan	-3.6	5.8	5.6
20	Chimelong Ocean Kingdom	Hengqin, China (new)	NA	NA	5.5

Source: Themed Entertainment Association

TABLE 4

Selected investment transactions, Sep 2015 - Mar 2016

Property name	Price (JPY bil)	Cap rate	Buyer
Leased land of Rihga Royal Hotel Osaka	27.0	NA	Rihga Royal Hotels
Loisir Hotel & Spa Tower Naha	20.0	5.9%	United Urban Investment
Hoshino Resorts Tomamu	18.3	NA	Shanghai Yuyuan Tourist Mart OBO Fosun Group
Urawa Royal Pines Hotel	17.5	5.8%	United Urban Investment
Active-Inter City Hiroshima	17.3	5.6%	Japan Hotel REIT

Source: Nikkei RE, RCA, Savills Research & Consultancy

Considering the expansion plan, Japan's Tokyo Disneyland may wrest the top spot from Disney's own Magic Kingdom in the US. Finally, Japan boasts three of the top five cities in the world — Tokyo, Kyoto, and Osaka — in terms of the number of Michelin Star restaurants and Tokyo retained the gourmet crown in Michelin's global rankings for the ninth straight year in 2015. A restaurant featuring ramen noodles took its place among more traditionally gourmet restaurants in Michelin's most recent report.

To meet this increased demand, the Japanese government and private sector are implementing new plans to expand capacity and provide services catering to foreign travellers. In April 2015 Narita International Airport opened an LCC-dedicated terminal, which has significantly brought down the cost of regional air travel, and Kansai International Airport is scheduled to open its own LCC-dedicated terminal in March 2017.

To accommodate more than 40 million visitors, regions in Japan should play a more important role than before since hotels in Tokyo and Osaka are operating at almost full capacity. Trends look to be shifting in this direction. With regions in Japan welcoming more tourists, Japan should not have a capacity issue.

Investments

The hotel investment market has remained active throughout 2015 and into 2016 as many J-REITs and developers are working to capitalize on the opportunities provided by increased international tourism. Data from Real Capital Analytics (RCA) indicate that there have been over 60 hotel transactions in the period August 2015 - February 2016, about half of which involved J-REITs or their sponsors. This is in line with the January 2015 - July 2015 period and active by historical standards. Hotel rent structures typically include a variable rent component which allows investors to capture additional upside when performance is strong.

This makes hotel property an ideal choice for bullish investors who wish to secure additional income without waiting for rent revisions. Robust ADR and RevPAR growth into 2016 paint a positive picture for investors hoping to profit from such variable rental income.

Cap rates for hotel transactions have been compressing throughout 2015, and prime locations in central Tokyo have sold at rates close to 4.0%.

OUTLOOK

The prospects for the market

The hospitality sector is likely to perform very strongly for the foreseeable future. The number of inbound tourists did not slow in January and February, and growth is expected to continue, albeit at a more moderate pace. Since Osaka and Tokyo are almost full, inbound tourists and international hoteliers have started to expand to outlying regions. There are many tourist attractions, including UNESCO World Heritage properties, outside of Tokyo, Osaka, and Kyoto, so regions show strong potential to attract travellers. The government's new goal of welcoming 40 million inbound tourists a year by 2020 should be achievable through this regional involvement and current favourable tailwinds. Such tailwinds include government support, a soft currency, flourishing LCCs, emerging Asian economies, popular tourist attractions, and the upcoming Olympics. The government and private sector are also spending more on multilingual services and devices. An unexpected disaster may change this trend, but for now the hospitality sector in Japan is enjoying a strong upward trend.

Please contact us for further information

Savills Japan

Christian Mancini
Representative Director, CEO
+81 3 6777 5150
cmancini@savills.co.jp

Savills Research

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

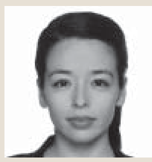
Hafiz Ismail
Manager, Research &
Consultancy, Japan
+81 3 6777 5171
hismail@savills.co.jp

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

Savills Hotels

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

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



Natasha Bell
Research Manager,
Asia Pacific
+65 6415 3622
natasha.bell@savills.com.sg