

Real Estate Analysis Report

Overview of the Japan Hotel Market

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Abstract

We overview the hotel market in Japan by means of several statistics, and forecast hotel demand for the next two years.

In the past, the lack of statistics prevented us from analyzing and predicting hotel market trends in Japan with reasonable accuracy. However, two new statistical surveys on hotels and tourism provide vital data for analyzing hotel demand for business as well as investment purposes.

We found that (1) total overnight visitors for both tourism and business decreased significantly in 2008 and 2009 following the Lehman shock; and (2) the bed occupancy rate, which also slumped after the Lehman shock, was actually already in decline at hotels for business due to new hotel supply.

According to our forecast for hotel demand, total overnight visitors will increase 2.0% in 2010 and 3.0% in 2011, bringing the number to only 89% of the peak level attained before the Lehman shock. Meanwhile, per capita lodging expenditure will increase 9.8% in fiscal 2010 and 0.1% in fiscal 2011, and thus remain significantly below the peak level attained before the Lehman shock.

Accurate data on hotel and tourism trends is particularly important because Japan's population decrease points to a hotel market downtrend. Hopefully, ongoing improvement of the statistics will help improve forecast accuracy.

Introduction

The latest available statistics for 2008 indicate that Japan has approximately 60,000 hotels with 1.6 million rooms.² While these numbers are not small, hotel properties remain a minor component of real estate investment in Japan. J-REITs now manage only 41 hotels, which comprise 2.2 % of all J-REIT properties by quantity.

¹ This is a condensed version of the original Japanese report (<http://www.nli-research.co.jp/report/misc/2010/fudo100427.pdf>) released on April 27, 2010. The author wishes to thank James Parker of NLI Research Institute for help with editing the English translation.

² Unless otherwise stated, we use the term "hotel" to include Japanese style inns called "ryokan."

There are several reasons that might explain the small amount of domestic investment in hotels. First, hotel evaluation is made difficult by the fact that hotel revenue depends heavily on the operator's management skills. In particular, restaurant and banquet operations generate a larger revenue share compared to other countries, and are more difficult to analyze and evaluate than lodging operations. Second, the "Uniform System of Accounts for the Lodging Industry" has yet to be widely adopted in Japan. Third, there is insufficient disclosure of transactions and management largely because of the lack of separation of ownership and management. Fourth, the lack of hotel and tourism statistics has made it difficult to analyze the market situation and trends.

However, in recent years, hotel and tourism statistics have improved remarkably due to the new emphasis on tourism development, including the Global Tourism Strategy formulated in 2002, Visit Japan Campaign begun in 2003, Basic Act for Promoting a Tourism-Oriented Country enacted in 2007, and Japan Tourism Agency (JTA) established in 2008. Two new statistical surveys called the *National Tourism Survey* and *Accommodation Survey* were initiated in 2003 and 2007 respectively, allowing us to grasp the occupancy rate of accommodations, number of overnight stays in Japan, and other key data. In addition, for the first time, a standardized survey of the number of visitors³ will be conducted nationwide in 2010.

While the statistical surveys are still relatively new and subject to modifications every year, the accumulated database has grown to the point that we can start to grasp trends in the Japan hotel market.

Based on the survey data, below we present a statistical overview of the hotel market in Japan, and a forecast for hotel demand in the next two years.

1. Room and Bed Occupancy Rate Trends

Since 2000, many global luxury hotel brands have entered the Japan market. In particular, just before the Ritz-Carlton Tokyo and the Peninsula Tokyo opened in 2007, the media speculated that a "Tokyo Hotel War" would erupt between foreign luxury hotels and traditional high-grade hotels, and referred to the potential hotel oversupply as the "year 2007 problem for Tokyo hotels." Thus amid the longest postwar economic expansion, the rush of foreign luxury hotel openings created a new luxury hotel market in Japan.

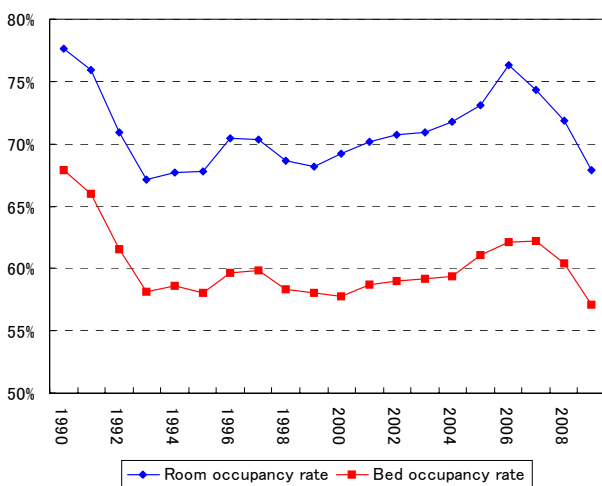
However, the economic slump after the collapse of Lehman Brothers in September 2008 dealt a sharp blow to the hotel market. According to the Japan Hotel Association, the occupancy rate of hotel rooms declined from 76.3% in 2006 to 67.9% in 2009 (Figure 1). Notably, at major hotels in Tokyo, the room occupancy rate was already in decline before the "Lehman

³ The new survey (観光入込客統計; *Kanko irikomi kyaku tokei*) does not yet have an official English name. Previously, the survey was conducted by local governments and was not standardized.

shock.” According to a *Nikkei Shimbun* survey, the room occupancy rate started declining in May 2006, and did not drop solely due to the Lehman shock (Figure 2).⁴

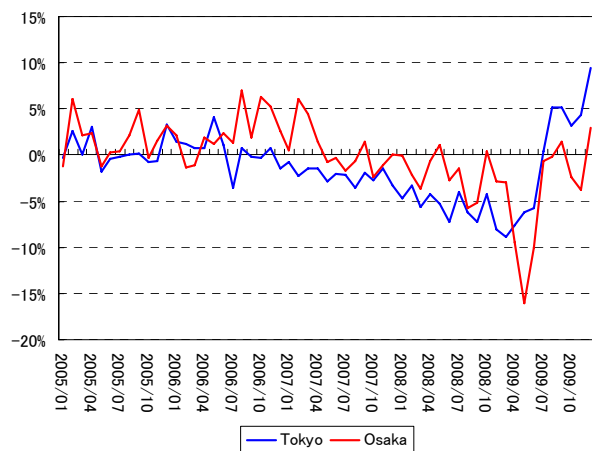
As a result, compared to the national trend, major hotels in Tokyo were not as badly hit after the Lehman shock. Incidentally, the sharp plunge in room occupancy rate at major hotels in Osaka from April to June 2009 can be attributed to the new influenza outbreak and strong yen. From August 2009, Tokyo’s room occupancy rate soared above Osaka’s, reaching for the first time above the December 2006 level.

Figure 1: Hotel Room and Bed Occupancy Rates in Japan



Source: Japan Hotel Association

Figure 2: YOY Change of Occupancy Rate of Major Hotels in Tokyo and Osaka



Note: Occupancy rate data was available to Dec. 2009.
Source: Compiled by NLI Research Institute from *Nihon Keizai Shinbun (Nikkei)* survey.

According to the *Accommodation Survey of 2009*,⁵ the room occupancy rate in 2009 was 53.0% at hotels for tourism,⁶ and 61.7% at hotels for business (Figure 3). Since the survey was begun in 2009, the growth trend cannot be calculated. However, similar data is available since 2007 in the form of the bed occupancy rate.⁷

The overall bed occupancy rate dropped from 45.2% in 2008 to 42.4% in 2009. The decline was most pronounced at hotels for business, dropping from 57.3% to 53.0% (Figure 4). As the quarterly data shows in Figure 5, while the overall bed occupancy rate dropped sharply after the Lehman shock, the rate at hotels for business was already in decline before the Lehman shock, similar to the room occupancy rate pattern of major Tokyo hotels in Figure 2. However, at

⁴ The sharp downturn for Osaka in April 2009 is due to the strong yen and the new influenza outbreak in the Osaka area.

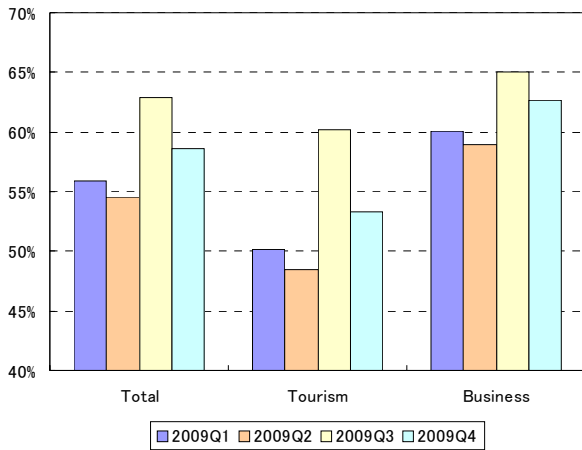
⁵ The *Accommodation Survey* is the only official statistical survey that measures hotel occupancy rates across Japan.

⁶ We refer to hotels in which the majority of visitors stay for tourism purposes as “hotels for tourism,” and hotels in which the majority of visitors stay for business purposes as “hotels for business.” Since the *Accommodation Survey* (宿泊旅行統計調査; *Shukuhaku ryoko tokei chosa*) does not have an English version, the translations presented here are tentative.

⁷ The bed occupancy rate (定員稼働率; *tei-in kado-ritsu*) measures occupancy in terms of total available beds rather than total available rooms.

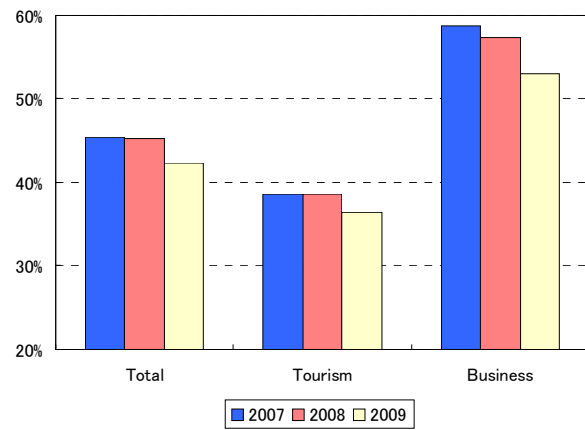
hotels for business, although the bed occupancy rate was already in decline in 2008Q1 (Figure 5), total overnight visitors did not start to decrease until 2008Q4. Thus the drop in occupancy rate before the Lehman shock was likely due to an increase in hotel room supply (Figure 6).

Figure 3: Room Occupancy Rate by Purpose



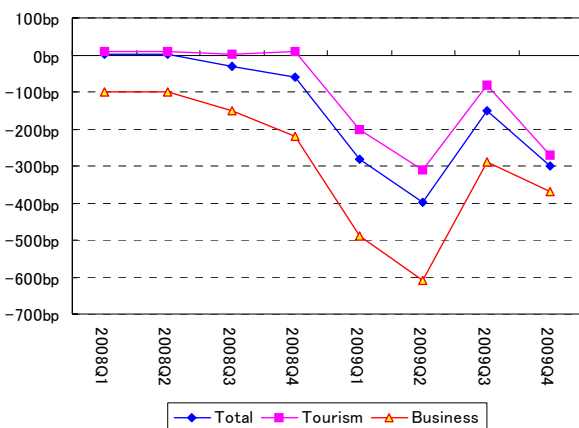
Note: "Hotels for tourism" are hotels in which the majority of visitors stay for tourism purposes, and "hotels for business" are hotels in which the majority of visitors stay for business purposes.
Source: Japan Tourism Agency, *Accommodation Survey*.

Figure 4: Bed Occupancy Rate by Purpose



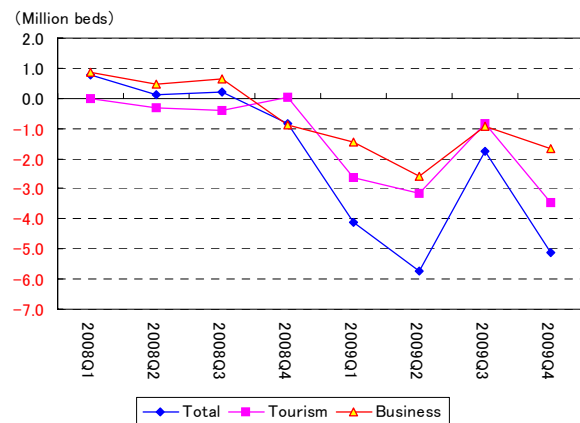
Note: See note in Figure 3.
Source: Japan Tourism Agency, *Accommodation Survey*.

Figure 5: YOY Change in Bed Occupancy Rate by Purpose



Note: 100bp is equal to 1%.
Source: Japan Tourism Agency, *Accommodation Survey*.

Figure 6: YOY Change in Total Overnight Visitors by Purpose



Source: Japan Tourism Agency, *Accommodation Survey*.

2. Development and New Supply of Hotels

The number of hotels and hotel rooms have both increased steadily in the past two decades, rising from 5,374 hotels and 397,346 rooms in 1990, to 9,603 hotels and 780,505 rooms in 2008 (78.7% and 96.4% increases respectively; Figure 7). On the other hand, the number of ryokans

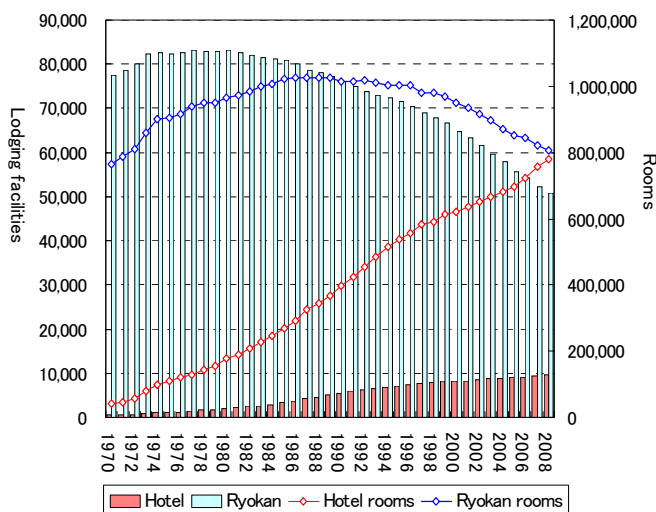
(Japanese style hotels) decreased over the same period from 75,952 ryokans with 1,014,765 rooms in 1990, to 50,846 ryokans with 807,697 rooms in 2008 (-33.1% and -20.4% declines respectively). As a result, the average number of rooms per hotel rose from 72.3 rooms in 1991 to 81.3 rooms in 2008. Despite this increase, the total number of rooms at hotels and ryokans has remained at approximately 800,000 rooms since 1992.

In 2008, the accommodation sector accounted for 1,171 building starts with 1,658,530 square meters of floor space (Figure 8). The floor space per hotel increased from 639 square meters in 2002 to 1,416 square meters in 2008.

In recent years, plans have been made public to construct a large supply of new hotels and expansions. But according to a December 2009 survey by Ota Publications, many of the plans became uncertain because of the financial crisis (Figure 9). In fact, 15 plans were canceled in the past year. The number of bankruptcies in the accommodation sector had increased until 2008, although the amount of debt per bankruptcy has decreased drastically since 2005. In a report released in September 2009, Teikoku Data Bank predicts that the number of bankruptcies in the accommodation sector will remain at a high level from now on (Figure 10).

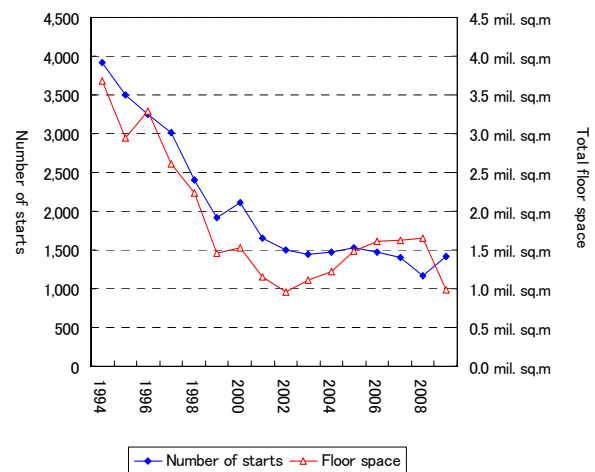
In summary, while the number of hotel rooms has increased considerably, the total number of rooms in the accommodation sector has remained at approximately 1.6 million rooms since the late 1990s due to an offsetting decrease of ryokan rooms. Meanwhile, average hotel and ryokan sizes have grown since 2002 due to the new development of large hotels combined with an increase of bankruptcies at mid-sized and smaller lodging facilities. Judging from the large number of construction plans that have turned uncertain, the demand decrease and financial crisis appear to have significantly impacted the new supply.

Figure 7: Number of Hotel and Ryokan Lodging Facilities and Rooms



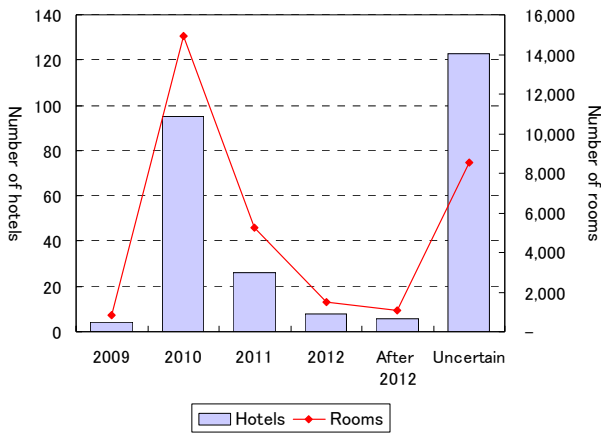
Source: Ministry of Health, Labor and Welfare

Figure 8: Number of New Building Starts in the Accommodation Sector



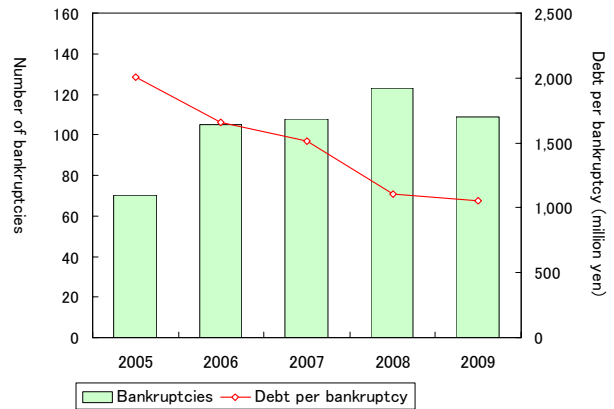
Source: Ministry of Land, Infrastructure and Transport and Tourism

Figure 9: Planned Supply of New Hotels and Expansions by Year of Opening



Source: Ota Publications

Figure 10: Number of Hotel and Ryokan Bankruptcies

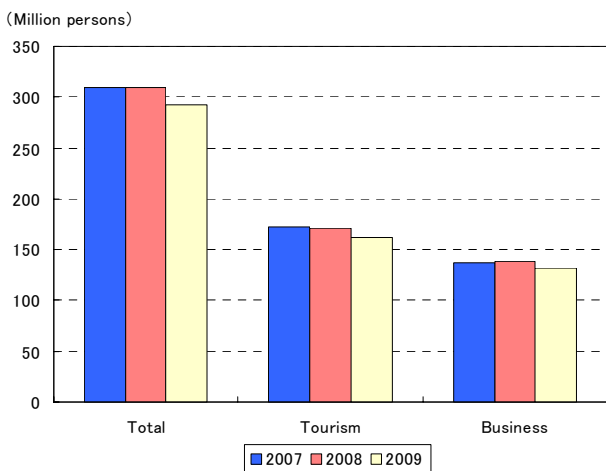


Source: Teikoku Data Bank

3. Demand for Hotel Rooms

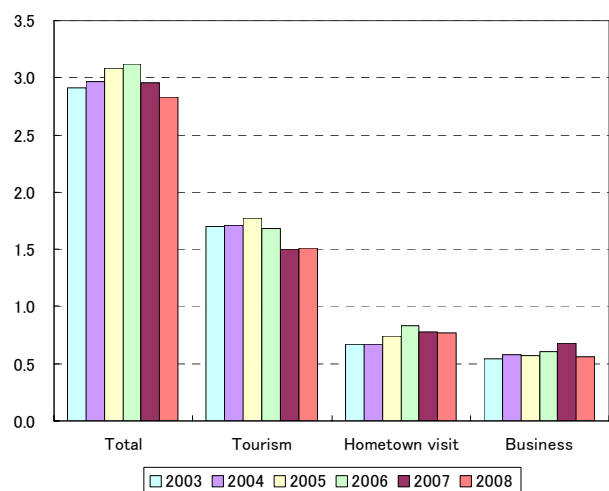
Earlier, we noted that total overnight visitors fell sharply in 2009Q1 (Figure 6). On an annual basis, total overnight visitors decreased -5.4% in 2009 to 293 million visitors, down from 310 million visitors in 2008 (Figure 11). Meanwhile, annual trips per capita also decreased from 3.12 trips in fiscal 2006 to 2.83 trips in fiscal 2008 (Figure 12). The latter can be attributed to the decline of business trips per capita from 0.68 trip in 2007 to 0.56 trip in 2008. On the other hand, the number of tourism trips increased from 1.50 to 1.51 trips in the same period. We should note, however, that the number of tourism trips has been trending downward from the peak of 1.71 trips in fiscal 2005.

Figure 11: Total Overnight Visitors by Purpose



Source: Japan Tourism Agency, *Accommodation Survey*.

Figure 12: Number of Domestic Trips Per Capita

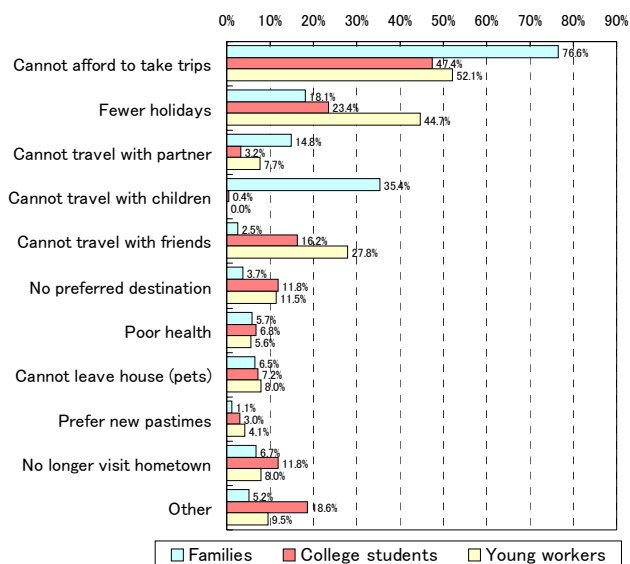


Source: Japan Tourism Agency, *National Tourism Survey*.

According to a survey by the Japan Tourism Agency, the main reason for downtrend of tourism trips is that families and young persons “cannot afford to take trips” (cited by 76.6% of families, 47.4% of college students, and 52.1% of workers under age 30; Figure 13). When asked for an explanation, young persons cited a “decrease of income” (40.5% of college students and 64.8% of young workers), while families cited “rising educational expenses” (61.2%) and “decrease of income” (51.1%).

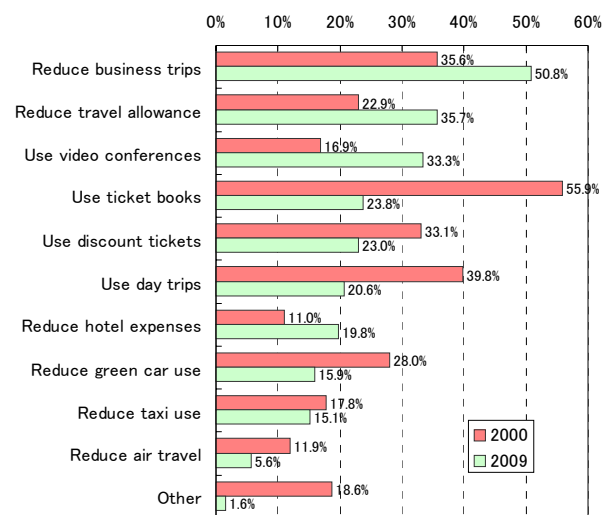
As for domestic business trips, 52.9% of companies reduced business trip spending in 2007 and 2008. The main categories of spending cuts were “reduce business trips” (50.8%), “reduce travel allowance” (35.7%), and “use video conferences” (33.3%; Figure 14).

Figure 13: Reasons for the Decline of Domestic Overnight Tourism Trips



Source: Japan Tourism Agency, *White Paper on Tourism* (FY2009).

Figure 14: Expenditure Cuts for Domestic Business Trips

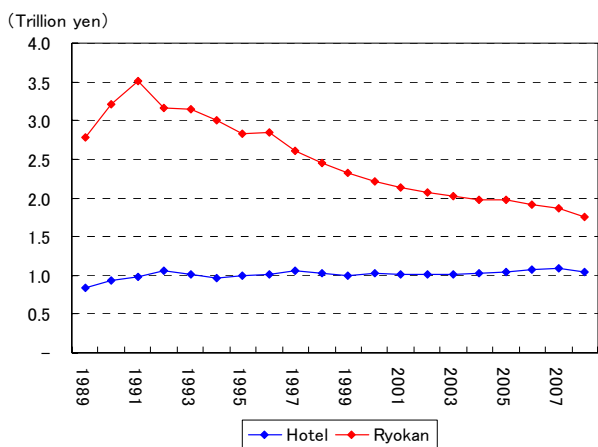


Source: *Rosei Jiho* no. 3754, July 24, 2009.

According to the Japan Productivity Center (JPC), the hotel market has steadily grown over the years and reached approximately 1.0 trillion yen in 2008, despite declining in that year due in part to the Lehman shock (Figure 15). The ryokan sector is still estimated to be 1.7 times larger than the hotel sector despite a persistent downtrend since 1991. The JPC estimate of the hotel market growth rate is largely derived from the GDP growth rate, based on the assumption that the two rates are closely correlated (Figure 16).⁸

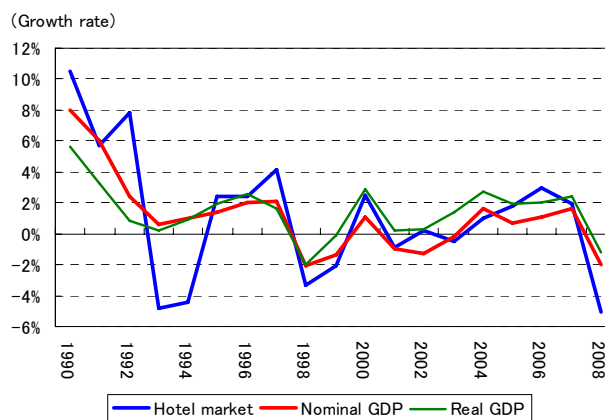
⁸ By comparison, according to the *Financial Statements Statistics of Corporations by Industry* (MOF), sales revenue of the accommodation sector is much more volatile and not as strongly correlated with GDP.

Figure 15: Market Size of Hotel and Ryokan Sectors



Source: Japan Productivity Center, *White Paper on Leisure*.

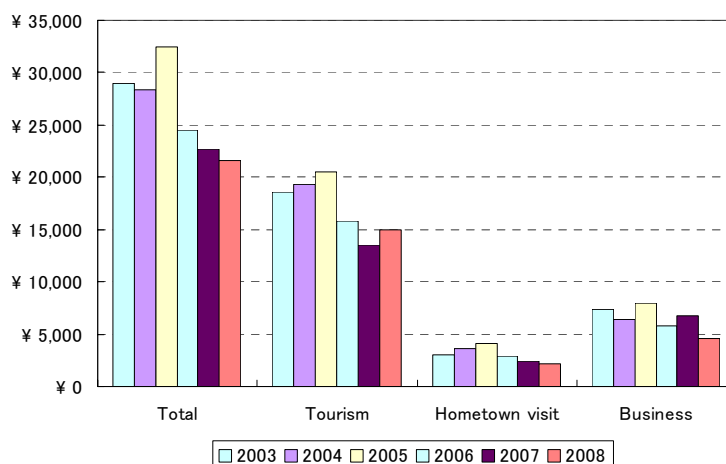
Figure 16: Growth Estimate of the Hotel Market and GDP



Sources: JPC, *White Paper on Leisure*; Cabinet Office.

Since both the number of annual domestic trips per capita and lodging expenditure per trip have decreased, annual per capita lodging expenditure decreased after the Lehman shock (Figure 17 and Figure 18). However, since the fiscal 2008 data covers only a half year period after the Lehman shock, the actual impact on lodging expenditure for tourism is not likely reflected in the data. The available data shows that from fiscal 2007 to 2008, the number of tourism trips edged up 0.7% while business trips plunged -17.6%. Moreover, per capita lodging expenditure for domestic tourism trips turned upward and rose 10.3%, compared to a -33.4% decline for business trips. Thus we must wait for more recent data to confirm the impact.

Figure 17: Annual Per Capita Domestic Lodging Expenditure (fiscal year)



Note: Due to abnormal fluctuations in the original data, 2005 values were recalculated by multiplying together survey data for number of trips per year, lodging expenditure ratio, and expenditure per trip.
Source: Japan Tourism Agency, *National Tourism Survey*.

Figure 18: Number of Annual Domestic Trips and Expenditure (per capita)

Item	Fiscal year	Overall	Tourism	Home visit	Business	Item	Fiscal year	Overall	Tourism	Home visit	Business
No. of trips (per capita)	2003	2.91	1.7	0.67	0.54	Average stay per trip (nights)	2003	2.02	1.65	2.85	2.16
	2004	2.97	1.71	0.67	0.58		2004	2.10	1.62	2.60	2.91
	2005	3.08	1.77	0.74	0.57		2005	2.06	1.63	2.91	2.28
	2006	3.12	1.68	0.83	0.61		2006	2.30	1.62	3.17	2.99
	2007	2.96	1.5	0.78	0.68		2007	2.11	1.61	2.69	2.55
	2008	2.83	1.51	0.77	0.56		2008	1.98	1.56	2.78	2.02
Expenditure per trip (per capita)	2003	57,398	60,140	55,729	50,849	Annual trip expenditure (per capita)	2003	167,028	102,238	37,338	27,458
	2004	59,293	63,049	53,768	54,632		2004	176,100	107,814	36,025	31,687
	2005	58,697	59,639	56,148	59,059		2005	180,787	105,561	41,550	33,664
	2006	58,081	62,895	53,224	51,431		2006	181,213	105,664	44,176	31,373
	2007	54,912	60,435	48,590	50,023		2007	162,540	90,653	37,900	34,016
	2008	55,186	61,346	48,900	47,157		2008	156,176	92,632	37,653	26,408
Lodging expenditure per trip (per capita)	2003	9,958	10,964	4,483	13,536	Annual lodging expenditure (per capita)	2003	28,978	18,639	3,004	7,309
	2004	9,530	11,327	5,423	11,097		2004	28,304	19,369	3,633	6,436
	2005	10,547	11,593	5,539	13,959		2005	32,485	20,520	4,099	7,957
	2006	7,862	9,407	3,531	9,457		2006	24,529	15,804	2,931	5,769
	2007	7,669	9,019	3,043	10,018		2007	22,700	13,529	2,374	6,812
	2008	7,620	9,884	2,804	8,107		2008	21,565	14,925	2,159	4,540

Source: Japan Tourism Agency, *National Tourism Survey*.

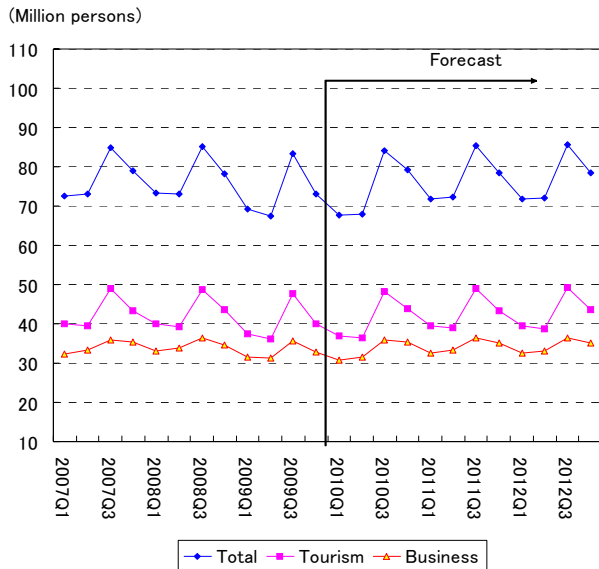
4. Short-term Forecast for Hotel Guests and Lodging Expenditure

We prepared a quarterly forecast for total overnight visitors to 2010 and 2011 based on data from the *Accommodation Survey*. Using the GDP growth rate forecast and a seasonal dummy as independent variables, we performed a separate regression analysis for hotels for tourism and business.⁹

According to our forecast results, total overnight visitors will increase 2.0% in 2010, and 3.0% in 2011 (Figure 19, Figure 20 and Figure 21). Thus the increase from 2009 to 2011 (+14.8 million visitors) will compensate for 89% (93% for tourism, 84% for business) of the drop in visitors from 2008 to 2009 (-16.7 million visitors) after the Lehman shock.

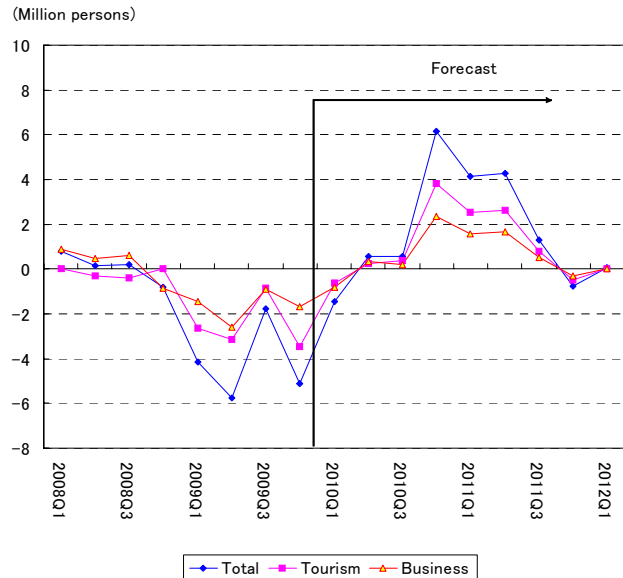
⁹ The GDP growth rate forecast was prepared by NLI Research Institute, and is available in Japanese at http://www.nli-research.co.jp/report/econo_letter/japan/we100312.html.

Figure 19: Forecast for Total Overnight Visitors by Purpose



Source: Forecast prepared by NLI Research Institute using data from Japan Tourism Agency, *Accommodation Survey*.

Figure 20: Forecast for YOY Change in Total Overnight Visitors by Purpose



Source: Forecast prepared by NLI Research Institute using data from Japan Tourism Agency, *Accommodation Survey*.

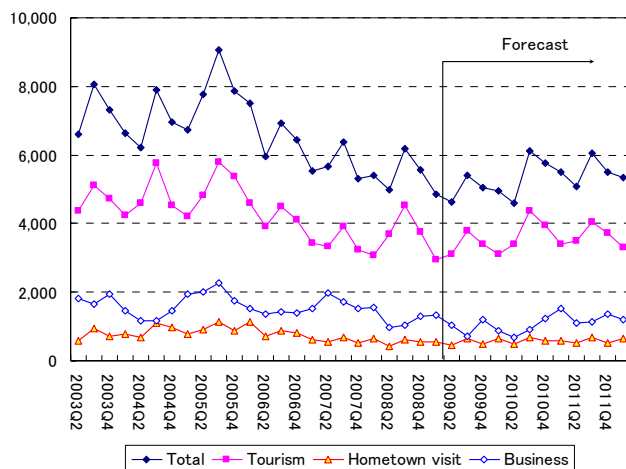
Figure 21: Forecast for Total Overnight Visitors by Purpose

	Year	Number of overnight visitors			Growth rate		
		Total	Tourism	Business	Total	Tourism	Business
Actual	2007	309,381,780	172,202,440	137,007,940			
	2008	309,698,710	171,497,840	138,106,860	0.1%	-0.4%	0.8%
	2009	292,954,360	161,428,090	131,466,530	-5.4%	-5.9%	-4.8%
Forecast	2010	298,808,799	165,251,407	133,557,392	2.0%	2.4%	1.6%
	2011	307,769,867	170,747,761	137,022,106	3.0%	3.3%	2.6%

Source: Forecast prepared by NLI Research Institute using data from Japan Tourism Agency, *Accommodation Survey*.

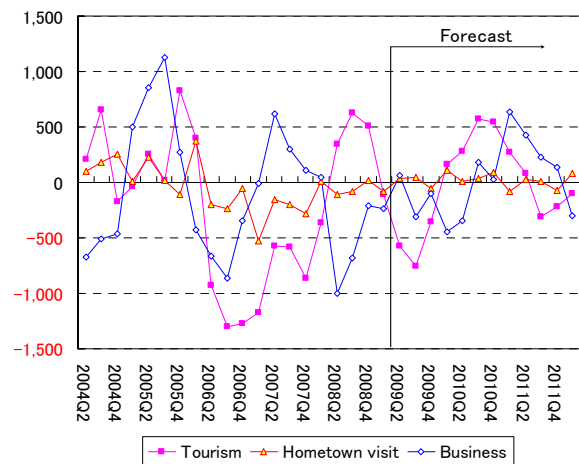
Next, we forecast the annual per capita lodging expenditure by multiplying together our forecast results for annual trips per capita (which is derived from the correlation with total overnight visitors), per capita expenditure per trip, and lodging expenditure ratio (total lodging expenditure / total trip expenditure). According to our results, annual lodging expenditure per capita dropped from 21,565 yen in fiscal 2008 to 20,018 yen (-7.2% decline) in fiscal 2009. But after four consecutive years of decline, it is predicted to increase to 21,988 yen (+9.8% increase) in fiscal 2010, and increase again to 21,988 yen (+0.1%) in fiscal 2011 (Figure 22, Figure 23 and Figure 24).

Figure 22: Forecast for Per Capita Lodging Expenditure (yen)



Source: Forecast prepared by NLI Research Institute using data from Japan Tourism Agency, *National Tourism Survey*.

Figure 23: Forecast for YOY Change in Per Capita Lodging Expenditure (yen)



Source: Forecast prepared by NLI Research Institute using data from Japan Tourism Agency, *National Tourism Survey*.

Figure 24: Forecast for Per Capita Lodging Expenditure

	Fiscal year	Annual lodging expenditure (per capita)				Year-on-year change			
		Total	Tourism	Home visit	Business	Total	Tourism	Home visit	Business
Actual	2003	28,978	18,639	3,004	7,309				
	2004	28,304	19,369	3,633	6,436	-2.3%	3.9%	21.0%	-11.9%
	2005	32,485	20,520	4,099	7,957	14.8%	5.9%	12.8%	23.6%
	2006	24,529	15,804	2,931	5,769	-24.5%	-23.0%	-28.5%	-27.5%
	2007	22,700	13,529	2,374	6,812	-7.5%	-14.4%	-19.0%	18.1%
	2008	21,565	14,925	2,159	4,540	-5.0%	10.3%	-9.0%	-33.4%
Forecast	2009	20,018	13,410	2,265	3,825	-7.2%	-10.2%	4.9%	-15.8%
	2010	21,975	15,083	2,317	4,320	9.8%	12.5%	2.3%	13.0%
	2011	21,988	14,541	2,353	4,806	0.1%	-3.6%	1.6%	11.2%

Source: Forecast by NLI Research Institute using data from Japan Tourism Agency, *National Tourism Survey*.

5. Importance of Expansion of Hotel Demand

As seen above, we forecast that the demand for hotels in Japan will increase for at least the next two years. Meanwhile, investors are concerned about the downtrend of hotel rent prices as reported by the Bank of Japan (Figure 25). In general, hotel rent prices seem to maintain a consistent ratio to sales and profit.¹⁰ Thus the decline of the hotel rent price index likely reflects the decrease of sales and profit of the hotel sector. In fact, the NOI (net operating income) of

¹⁰ According to Deloitte Tohmatsu FAS in *Hotel Restaurant* (April 11, 2008), the appropriate ratio of rent to GOP (gross operating profit) is between 60% and 80% in Japan. Moreover, in the same magazine, Mr. Uemura of AM Works states that the GOP/sales ratio of “business hotels” is between 40% and 60%, and that of “city hotels” is 10% to 30%. Thus we expect that the appropriate rent/sales ratio is between 24% and 48% for “business hotels,” and between 6% and 24% for “city hotels.”

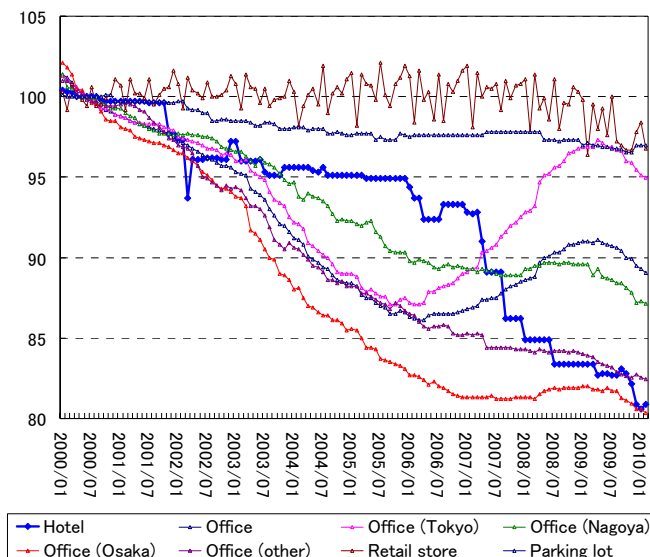
J-REIT hotel properties and unit dividend of hotel REITs have been stagnant or in decline (Figure 26 and Figure 27). Therefore in order for the hotel rent price to recover, it is necessary for hotel sales and profit to grow through the expansion of hotel demand.

In the long term, we are concerned about the decrease of domestic demand for hotel stays. The Japan Tourism Agency predicts a decrease of trip demand based on the following reasons: (1) the number of trips by young people has decreased; (2) trip experiences encourage people to take more trips, but young people today do not have enough trip experiences; (3) lack of trip experiences now will cause the number of family trips to decrease in the future; (4) this means their children will also lack trip experiences, and will not travel very much when they become adults.

From these assumptions, hotel demand can be stimulated only by increasing the number of trips for business and inbound trips by foreigners. However, we cannot expect a large increase in business trips because Japan's productive-age population is decreasing. Thus although the number of foreign overnight visitors in 2009 was only 1.78 million visitors or 6.1% of the total, growth of inbound visitors will become a significant factor for the hotel sector in consideration of the decrease of Japan's population and declining number of trips by Japanese.

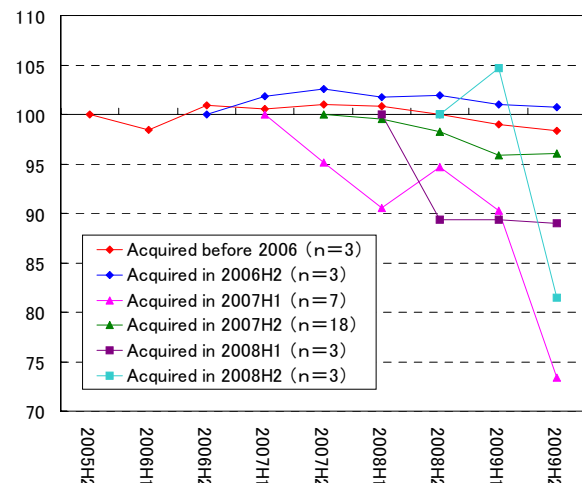
Still, the principal challenge is to stimulate domestic demand. In particular, elder people exhibit a high potential as travelers and overnight visitors because this age segment is projected to increase despite the decrease of the Japanese population.

Figure 25: Sharp Decline of Hotel Rent Price



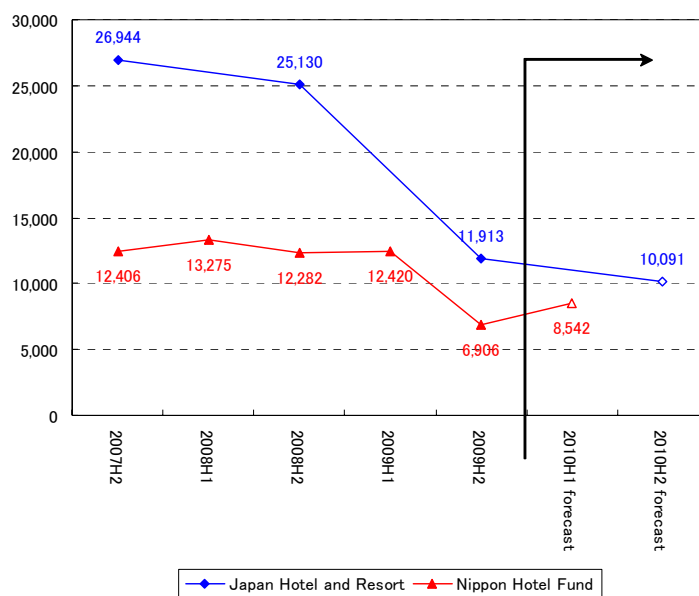
Source: Bank of Japan, *Corporate Service Price Index*.

Figure 26: NOI Trend of J-REIT Hotel Properties by Acquisition Date



Source: Compiled by NLI Research Institute using data from J-REITs.

Figure 27: Unit Dividend of Hotel REITs (Yen)



Source: NLI Research Institute

6. Conclusion

Based on the two new statistical surveys on hotels and tourism, our analysis of hotel market trends reveals the following: (1) total overnight visitors for both tourism and business decreased significantly in 2008 and 2009 following the Lehman shock; and (2) the bed occupancy rate, which also slumped after the Lehman shock, was actually already in decline at hotels for business due to new hotel supply.

In our forecast for hotel demand, total overnight visitors will increase 2.0% in 2010 and 3.0% in 2011. As a result, the total number will recover to only 89% of the peak level attained before the Lehman shock. In addition, per capita lodging expenditure will increase 9.8% in fiscal 2010 and 0.1% in fiscal 2011, and thus stay well below the peak level attained before the Lehman shock.

Regarding the new public statistics on hotels and tourism, it is still too early to fully use the survey data for analyzing Japan's hotel market. But with continued improvement and accumulation, the survey data will become indispensable to business users and investors who need to grasp hotel market trends, particularly since demographic trends point to a secular downtrend ahead.