Hotels & Hospitality Group
July 2023

1H 2023 Highlights
Australian Hotel Market

JLL SEE A BRIGHTER WAY

Introduction

The Australian hotel market continues to see a strong recovery across the board, highlighting the strength and attractiveness of the market's fundamentals. Underpinned by the domestic leisure segment, ADR and RevPAR has now recorded a full recovery across all major capital city markets, against 2019 levels. The steady rebound in corporate and MICE segments as well as inbound demand is expected to support the further growth of the country's diverse city and regional hotel markets.

The first half has also seen the introduction of numerous new hotels and international brands, as the nation's unprecedented supply wave nears its end. Despite ongoing headwinds such as interest rate rises and a pricing discovery journey across core asset classes, investment activity has also seen an uptick, albeit for assets with that are aspirational (trophy or strategic) and those with genuine value-add and upside potential.

As has been evident over the course of 2023 so far, the following five themes are anticipated to continue shaping the market in the short to medium term:

1. Visitor arrivals continue to improve, driving hotel trading
2. RevPAR surpassed pre-COVID levels, owing to strength in ADR's
3. Unprecedented supply cycle coming to an end
4. Despite current headwinds, investment activity remains strong
5. RBA tightening policy continues, however market expectation is close to rate peak

1

Visitor arrivals continue to improve, driving hotel trading

Domestic travel within Australia continued to lead the recovery over the first half of 2023, with monthly domestic visitor arrivals trending back around pre-COVID levels. This travel remained heavily weighted to leisure tourism for both city and regional markets, especially in the earlier months of the year. MICE and corporate demand also saw an uptick in key city markets with business travel and in-person conferences showing strong signs of recovery, despite the current macroeconomic headwinds and pullback on many business' travel and entertainment budgets.

This recovery has been mirrored by Australia's two busiest airports, Sydney and Melbourne, which in May 2023 recorded a strong rebound in total passenger traffic, domestic and international, of 86% and 90%, respectively relative to pre-COVID levels. Additionally, the Melbourne to Sydney (MEL-SYD) domestic flight route returned to the overall top 10 list, ranking as the fifth busiest airport route globally (~783,000 seats for the month of July 2023), which further illustrates the recovery in air lift capacity and pick-up in business travel between Australia's two major corporate CBD's.

Since the reopening of Australia's international borders back in February 2022, there has been a steady recovery in international arrivals across the country. The uptick in inbound demand has resulted in an increased air lift capacity and flight routes, which is facilitating improving connectivity and making it more accessible than ever to travel to, from and within Australia. As per the ABS, short-term international visitor arrivals reached a monthly post-COVID peak in December 2022 (648,970 arrivals), however this remained 40% down on December 2019 levels (1.08 million arrivals). Over the first four months of 2023 (YTD April), short-term overseas arrivals totalled 2.17 million, and whilst improving, remains 32% down on the same period pre-COVID levels (YTD April 2019).

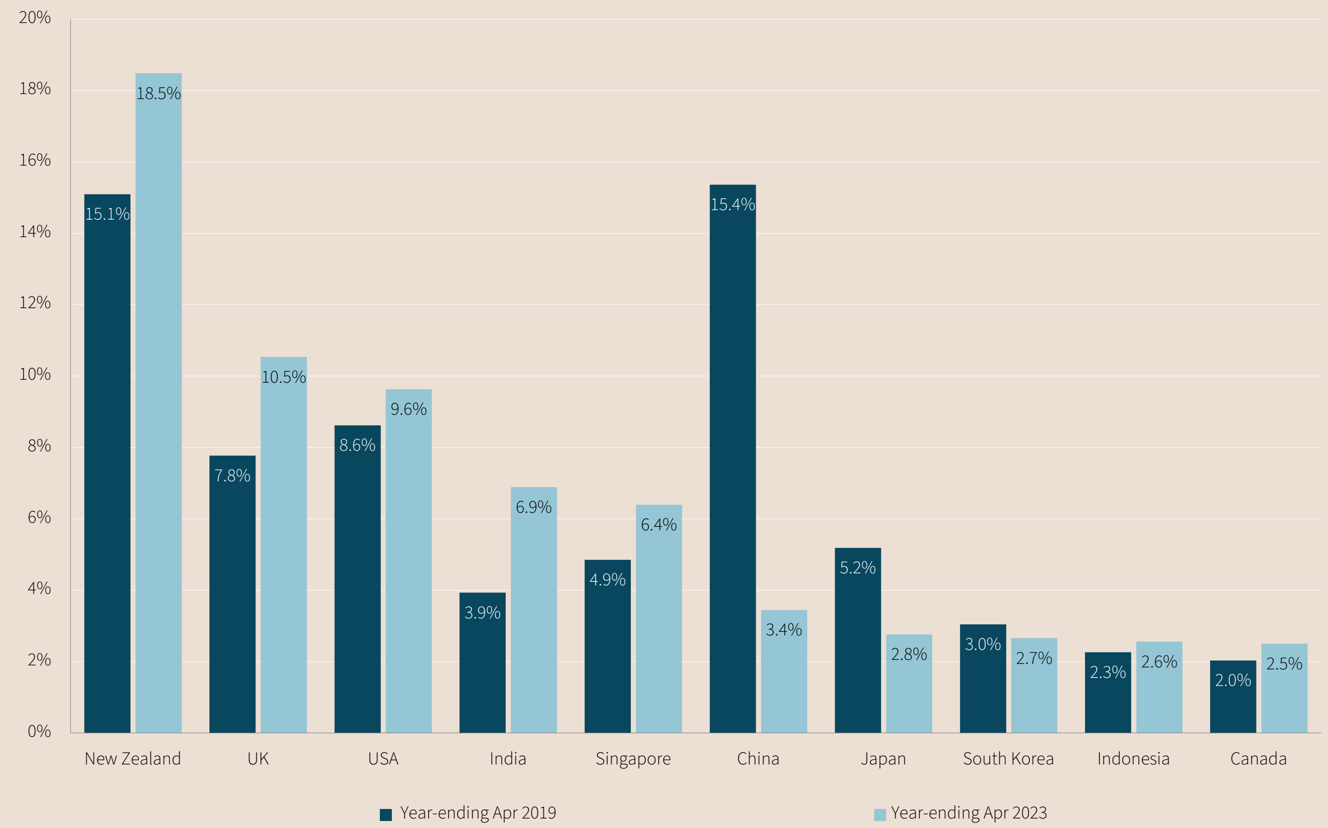
Prior to the pandemic (year ending April 2019) Australia's top five source markets of short-term international visitation were China (15.4%), New Zealand (15.1%), USA (8.6%), UK (7.8%) and Japan (5.2%). Australia has since seen its demand sources shift on the back of delayed border openings, long winded COVID protocols and geopolitical threats, with the current top five source markets for the year ending April 2023, being New Zealand (18.5%), the UK (10.5%), USA (9.6%), India (6.9%), and Singapore (6.4%).

The significant loss of Australia's top source of overseas tourism, Mainland China, which accounted for over 1.4 million visitor arrivals back in 2019, unfortunately continues. Despite the reopening of China's border's, Australia remains off the list of its approved outbound group tour destinations, which is one of the factors that is prolonging a faster recovery in visitor numbers.

Thankfully, statistics released by Tourism Research Australia's National Visitor Survey (NVS) saw Australia's domestic overnight spend for the month of March 2023 reach $8.5 billion, significantly surpassing March 2019 totals (up 32%), despite overnight trips being slightly down on pre-COVID levels (-5%). However, the International Visitor Survey (IVS), which reports on an annual basis rather than monthly, reported international overnight spend for the year-ending March 2023 was $18.3 billion, well below year-ending March 2020 levels (-36%), with overnight trips also down on pre-COVID levels (-33%).

Despite the ongoing headwinds, the hotel trading outlook remains positive, and we anticipate a continued strong recovery in visitation over the short-to-medium term, with Sydney and Melbourne markets expected to be the major beneficiaries. This will support rebounding demand of both business and leisure travel, especially given pent-up demand to travel, increased flight capacities, moderating airfare costs and a further rebound in international travel.

Top 10 Source Markets



Source: ABS (Overseas Visitor Arrivals – Short-term)

2 RevPAR surpassed pre-COVID levels, owing to strength in ADR's

All major city markets across Australia have now achieved a full RevPAR recovery, largely a result of the strong rate growth that has been achieved across all hotel categories over the past 12 to 18-months. ADR's are outperforming pre-COVID levels across all major markets, with this growth attributed to factors such as a rebalance of business and rate structures, improved product offering in many markets, and willingness for guests to pay higher rates coming out of COVID.

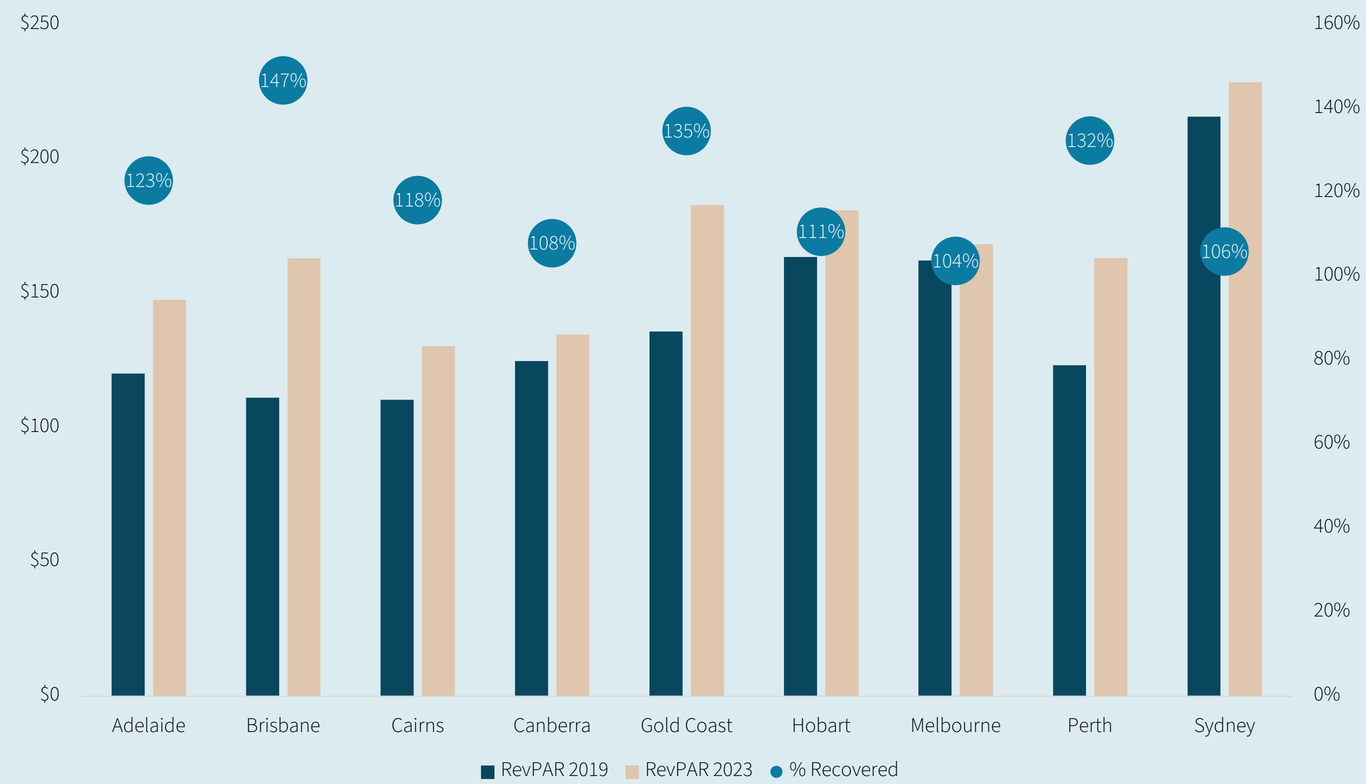
The markets currently with the strongest ADR growth since the corresponding period pre-COVID (YTD June), albeit some off a lower base, are Brisbane (+48%), Cairns (+46%), Adelaide (+44%), Gold Coast (+40%) and Perth (+35%). Consequently, the strongest RevPAR growth on 2019 levels has been seen in Brisbane (+47%), Gold Coast (+35%), Perth (+32), Adelaide (+23%) and Cairns (+18%).

Additionally, despite occupancy rates steadily picking up over the past 12 months, YTD occupancy in most markets remain down on historic pre-COVID levels. This is especially the case within markets that have seen significant levels of new supply, or with a heavy reliance on corporate and MICE business and international demand (such as Sydney, Melbourne, Adelaide, Canberra & Cairns) due to the slower recovery in these segments.

Notwithstanding the recent announcement regarding the 2026 Commonwealth Games, Australia continues to grow its strong, ever-evolving calendar of world class events and festivals, which has attracted an influx of international and interstate leisure demand to respective markets. Over the first half of the year many markets have hosted numerous global and regional events, which has seen peaks in room night demand, occupancy, and ADR levels. These include, and are not limited to, the Australian Open Tennis, F1 Australian Grand Prix, LIV Golf, AFL Gather Round, World Pride, Vivid Sydney as well as ongoing sporting seasons and global touring artist concerts, achieving record attendances. Furthermore, upcoming events and holiday periods are also seeing strong spikes in forward bookings and rates, such as Women's Soccer World Cup, the inaugural SXSW, Melbourne Cup, Taylor Swift concerts, and much more.

Heading into the back half of 2023, we are expecting to see increasing pressures facing the domestic leisure segment, as current interest rate rises curb consumers discretionary spending and the pick-up in outbound international travel continues, which is set to impact markets primarily relying on this demand. However, the steady recovery of business travel and the corporate/MICE segment, as well as the rebound in international visitor arrivals will likely support key gateway markets (Sydney and Melbourne), which are expected to see RevPAR growth throughout the remainder of the year as the market's continue to normalise.

RevPAR Recovery by Market



Source: STR (YTD June)

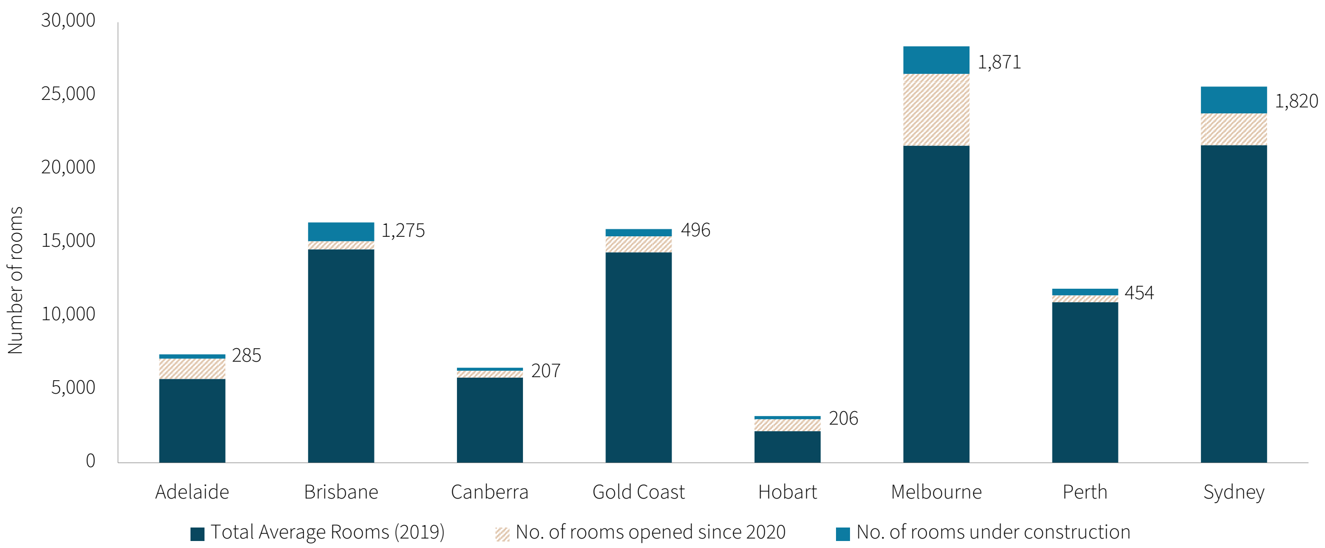
3

Unprecedented supply cycle coming to an end

Australia has undergone one of its most significant new supply waves over the past four years, with many market's hotel landscapes expanding and absorbing significant levels of new stock. However, with the supply cycle nearing its end, the addition of this new product in the market is driving owners of many existing hotels to pursue refurbishment and repositioning strategies in order to remain competitive.

In regards to total supply increases since the onset of the pandemic (start of 2020), Hobart has recorded the largest increase on existing 2019 stock levels (+48%), followed by Melbourne (+31%), Adelaide (+29%) and Sydney (+18%). However, by quantum of rooms, Melbourne has seen the largest majority of new hotels commence trading with 4,889 rooms (21 hotels) opening since the start of 2020, followed by Sydney (2,159 rooms – 13 hotels), Adelaide (1,388 rooms – 9 hotels) and the Gold Coast (1,086 rooms – 5 hotels).

New Supply Breakdown by Market



Source: JLL (as at 30 June 2023)

Over the first half of 2023, four new hotels opened in Melbourne, adding an additional 703 rooms to the market (2.9% increase on total stock). These include the Nesuto Docklands (211 rooms), as well as the entry of high-end international brands Le Meridien (235 rooms), Ritz Carlton (257 rooms) and the Dorsett (316 rooms). Other notable first half supply additions that have come online across the country, include the Capella Sydney (192 rooms) and 202 Elizabeth (38 rooms) in Sydney and the Vibe Hotel (123 rooms) and Tryp by Wyndham (120 rooms) in Adelaide.

Whilst the new supply wave has greatly enhanced the overall product offering within the market and helped lift ADR ceilings, it also continues to place significant pressure on many owners of existing older assets, leading them to assess the ongoing viability of their hotel operations given the high capital cost for them to refurbish. There is a high likelihood that hotels with a higher and better use will continue to be taken out of the market, just as we've seen recently with the likes of Sir Stamford Circular Quay in Sydney, and Hotel Lindrum and Bayview Eden in Melbourne.

Future hotel supply is largely situated within the three eastern seaboard capital city markets. Melbourne currently has the largest pipeline nationally, with 1,871 rooms under construction, set to add 8.7% of total room stock, followed by Sydney with 1,820 rooms (8.4% of total stock) and Brisbane has 1,275 rooms (8.8% of total stock). A number of premium projects currently under construction across Australia include, the W Hotel Sydney, Queens Wharf Brisbane (The Star, Rosewood & Dorsett), Mondrian Gold Coast, GPO Marriott Adelaide, Shangri-La Melbourne, EQ West Hotel Perth, 1 Hotel Melbourne and the Waldorf Astoria Sydney.

Development activity is expected to remain somewhat constrained over the short term, as projects continue to be impacted by feasibility challenges such as increasing construction costs, rising interest rates and the availability of development finance. However, as market conditions begin stabilise and current supply is absorbed, we expect there will be further new developments announced over the near term.

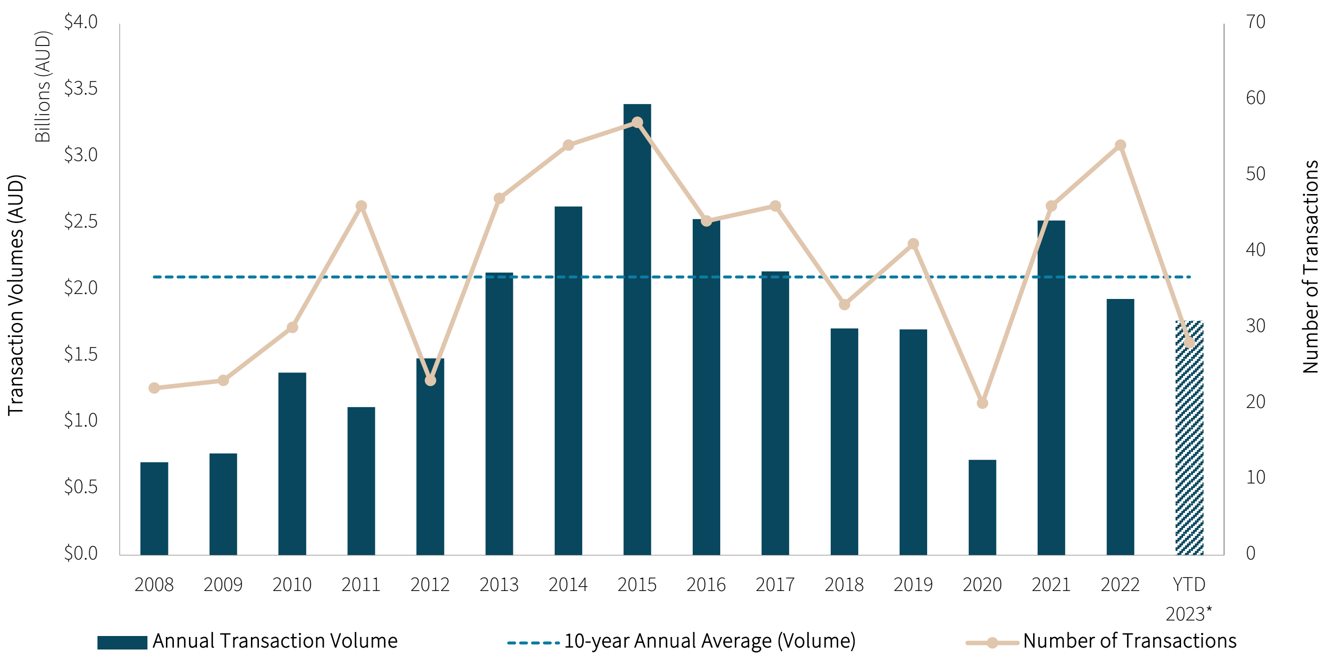
4 Despite current headwinds, investment activity remains strong

Total hotel investment volumes in Australia totalled AUD 1.93 billion in 2022, which was a slight y-o-y decline (23%) on 2021 volumes but only marginally below the 10-year long-term average (AUD 2.09 billion). Investment momentum and capital market activity has been strong over the first half of 2023 on the back of a number of notable transactions. We have already recorded close to $1.19 billion of transactions having settled to YTD June, and another ~$580 million of deals that have exchanged.

This brings 1H23 total hotel investment volumes to around AUD 1.76 billion across 28 transactions, which in a strong sign of investor confidence is already 91% of the total annual volume last year. We note however, of these transactions, the top five deals (by value) made up 64% (AUD 1.13 billion) of total transaction volumes, led by several landmark deals such as the Waldorf Astoria Sydney, Sheraton Grand Mirage Resort, Sofitel Brisbane and the Spicers Retreats and Escarpment Group portfolios.

Investors remain readily eager to deploy capital in Australia, albeit with a clear trend of 'flight to quality' occurring, with transaction activity predominately targeting aspirational assets (trophy or strategic) and properties with genuine value-add and upside potential.

Australian Hotel Investment Volumes



Source: JLL (as at 30 June 2023)

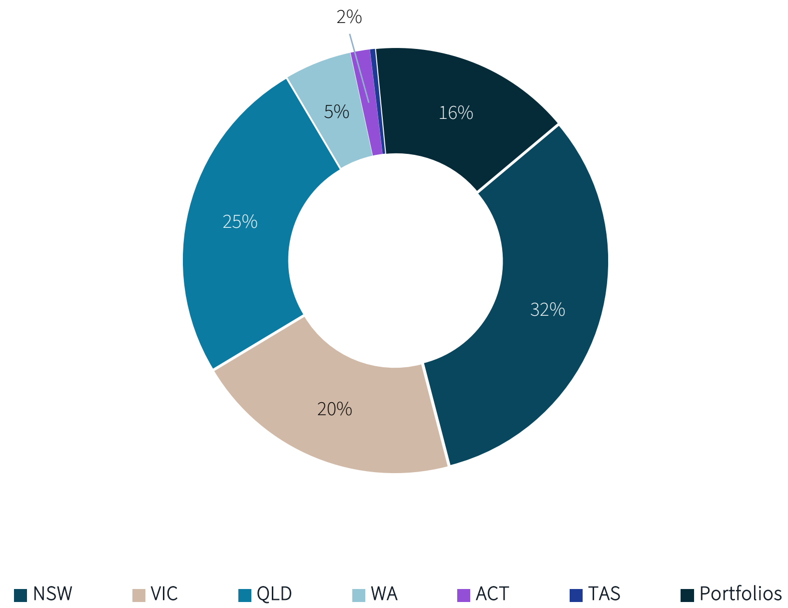
As was the trend last year, capital flows have been heavily weighted to domestic buyers, making up 86% of total investment volumes, although many of these investors have offshore limited partners. Subsequently, to start the year there have only been a handful of transactions attributed to overseas capital, largely from groups out of Singapore.

The mid-markets space has also remained highly active, with investors targeting both regional and coastal locations, as well as those assets with upside potential, be that through repositioning plays and redevelopment opportunities.

Despite New South Wales historically dominating investment volumes, especially over recent years, the first half of 2023 has seen activity relatively dispersed on a state level. New South Wales accounted for 32% of settled and exchanged transaction volumes, followed by Queensland (25%) and Victoria (20%).

Investor interest in the hotel sector remains relatively high, but selective, especially in the current environment as a hedge against inflation. We anticipate the hotel investment market will remain robust and active over the short term, with transaction volumes projected to reach in excess of AUD 2.2 billion for the full year, despite the current macroeconomic headwinds and challenges surrounding investment underwriting.

Transaction Volumes by State



Source: JLL (as at 30 June 2023)

Sheraton Grand Mirage
Gold Coast, QLD
Sale Price: $192m | **Buyer:** Laundy/Karedis Family | **$ / room:** $650,847

Bayview Eden
Melbourne, VIC
Sale Price: $78.5m | **Buyer:** Home (GIC) | **$ / room:** $408,854

Garema Centre Abode Hotel
Canberra, ACT
Sale Price: $26m | **Buyer:** TP Dynamics | **$ / room:** $122,642

Adelphi Hotel
Melbourne, VIC
Sale Price: $25m | **Buyer:** Virtical | **$ / room:** $735,294

Geraldton Motor Inn
Geraldton, WA
Sale Price: $10.3m | **Buyer:** CBH Group | **$ / room:** $170,833

Scamander Beach Resort
Scamander, TAS
Sale Price: $6.9m | **Seller:** Vision Hotels | **$ / room:** $116,102

Sheraton Grand Mirage, Gold Coast QLD

5

RBA tightening policy continues, however market expectation is close to rate peak

The first half of 2023 has been notable for the continued monetary policy tightening, which has been seen across the globe, with Japan being the only mature economy to hold rates towards record lows seen during and pre-COVID. The RBA has been no exception to the global trend, having 12 rate hikes in the past 14 meetings, and raising rates four times during the first half, from a cash rate of 3.1% at the beginning of the year, to 4.1% today.

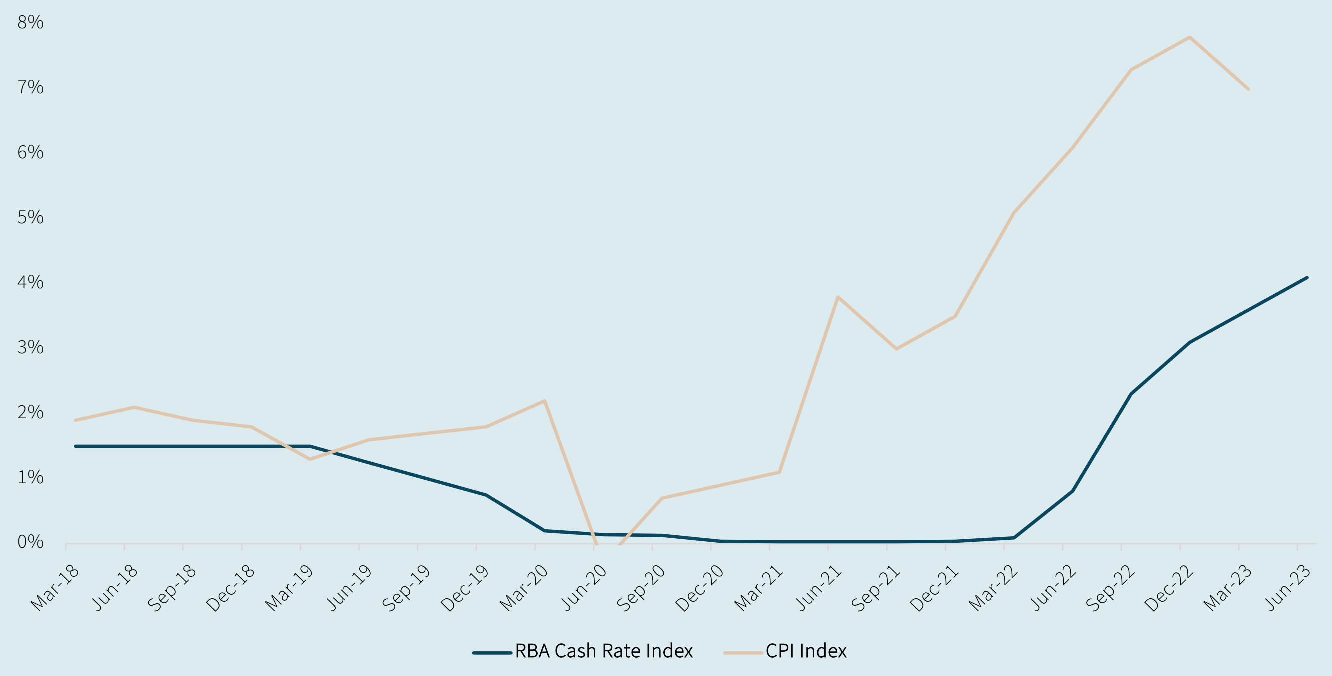
Whilst inflation is now trending down, with the May figure being below analysts' expectations at 5.6%, the majority of the market is still expecting one or two further cash rate increases (of 25bps) before the top of the cycle is reached. This would mean rates peaking between 4.35% – 4.6%, which would still sit below the US Fed rate that is already over 5%. The RBA's messaging remains clearly centred on its desire to return inflation to its targeted bandwidth (2% - 3%), and as such expectations are for no fall in rates until 2024.

The rapid rise in lending rates has meant that lenders have become increasingly active in their review of their loan books, with the office sector in particular coming under scrutiny as values come into focus. In the hotels space, consistently strong cashflows have generally kept lenders appeased in the short term, while they have been focused on other sectors. Though Interest Cover Ratio's (ICR's) covenants have certainly come under pressure recently in some localities, borrowers have been encouraged to remain closely engaged with their banks to keep ahead of any challenges arising, particularly in any markets which may see peak guest demand soften slightly.

Major Australian Bank appetite remains for hotel and hospitality lending, though banks appear to be becoming even more selective in their choice of assets and sponsors, particularly for development finance. Capital city locations and portfolio owners are the most coveted by the big banks, whilst properties with ramp-up/capex risk and/or in secondary locations may be less preferred. The selectiveness of Australian Banks is providing opportunities for overseas and non-bank lenders, who are looking to increase their exposure in the sector.

The non-bank space remains competitive for lenders, with borrowers seemingly having more choice than ever before. Non-bank lenders remain willing to stretch Loan-to-Value ratios (LTV's) and providing greater flexibility around covenants. Anecdotally, competition for the best deals has seen a slight compression in pricing at the top of the market, and as the cash rate has increased, the differential between non-bank and bank pricing has become less, increasing the attractiveness of non-bank lenders. In the event that some banks may not be willing to refinance part of a portfolio, we consider there to be multiple options for borrowers.

Australia's RBA Cash Rate and Inflation



Source: Bloomberg, ABS

Australia's Forward Swap Rates

Source: Refinitiv Eikon

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