



MaxCap
Investment Management

MAXCAP AUSTRALIAN HOTEL MARKET UPDATE 2022

MAY 2022

AUSTRALIAN HOTEL MARKET UPDATE 2022

OVERVIEW

- The Australian Accommodation, Hotel and Tourism sectors performed ahead of market expectations well into 2021, before the emergence of the Covid-19 Delta variant resulted in extended lockdowns across much of Australia. However, as vaccination targets were reached and restrictions relaxed, a strong uptick in hotel bookings in November and December saw the last quarter of 2021 show early signs of a recovering sector.
- Governments remained committed to keeping Australia's economy and borders open through the Omicron variant wave in late 2021/early 2022 providing further evidence the recovery will continue.
- The global success of the vaccine and booster rollout has strengthened consumer confidence and led to cautious optimism on recovery of the sector.
- Australia's hard border restrictions were lifted in Q1 2022, earmarking recovery for the tourism and accommodation sectors with a potential influx of tourists, students, and working-holiday makers.
- Interstate travel leads the sector in the medium term, partially offsetting the absence of international travel, which is not expected to return to pre-pandemic levels for several years.
- Major banks have continued to be conservative lending to the sector, both to new builds and existing trading assets. This has provided further opportunity for non-bank lenders to selectively participate in strong risk-adjusted debt opportunities which otherwise would not be available.

MARKET COMPOSITION



Source: STR, Tourism Research Australia

As of June 2021, there were approximately 304,765 accommodation rooms across Australia, an increase of approximately 21,000 rooms from June 2020 figures. This includes hotels, resorts, motels, serviced apartments and holiday parks (Table 1).

In the year ending September 2021, the combined value of total international and domestic overnight visitor spend across Australia was approximately \$62.2bn¹. Notably, domestic overnight spend contributed 98% of this amount, equivalent to \$60.9bn² demonstrating the stable demand for inter and intra-state product. This was particularly influenced by the Australian border closures. In comparison to the year ending September 2020, domestic overnight spend fell to 78% of its previous annual value at \$77.5bn³. In the near term, it is also expected that domestic tourism will continue to benefit from a slower rebound in outbound travel than in domestic travel.

Foreshadowing the recovery of international visitors, new hotel openings have continued through 2021 and it is forecast that the next 12 months will see a burst of new rooms, marking the development cycle peak.

Global trends indicate a future uptick in activity is likely. Airbnb reported a record \$834 million in revenue during Q3 2021

- New South Wales continues to house the highest number of accommodation rooms being the largest economy and most mature hotel market in Australia. The state is popular with international and domestic tourists, as well as retaining a large volume of corporate travellers. The Sydney and Melbourne flight route has once again found itself rank highly as one of the world's busiest domestic flight routes in the world⁴, taking seventh place in 2021, and previously second in 2018.

TABLE 1: AUSTRALIAN ACCOMMODATION BREAKDOWN – BY TYPE

ACCOMMODATION TYPE	2019 - 2020		2020 - 2021		YOY CHANGE	
	#	%	#	%	#	%
Hotels & Resorts	135,078	47.6%	152,764	50.1%	17,686	13.1%
Motels/Private Hotels	61,952	21.8%	63,556	20.9%	1,604	2.6%
Serviced Apartments	73,122	25.8%	74,338	24.4%	1,216	1.7%
Holiday Parks	13,549	4.8%	14,107	4.6%	558	4.1%
Total by Accommodation Type	283,701		304,765		21,064	7.4%

Source: STR

TABLE 2: AUSTRALIAN ACCOMMODATION BREAKDOWN – BY CLASS

CLASS	2019 - 2020		2020 - 2021		YOY CHANGE	
	#	%	#	%	#	%
Luxury and Upper Upscale Classes	55,664	20%	65,940	22%	10,276	18.5%
Upscale and Upper Mid Classes	119,747	42%	128,476	42%	8,729	7.3%
Midscale and Economy Classes	108,290	38%	110,349	36%	2,059	1.9%
Total by Class	283,701		304,765		21,064	7.4%

Source: STR

TABLE 3: AUSTRALIAN ACCOMMODATION BREAKDOWN BY STATE AND TERRITORY

STATES AND TERRITORIES	HOTELS/RESORTS/MOTELS		SERVICED APARTMENTS AND HOLIDAY PARKS		TOTAL ACCOMMODATION	
Australian Capital Territory	5,225	2%	2,303	3%	7,528	2%
New South Wales	71,321	33%	21,057	24%	92,378	30%
Northern Territory	6,599	3%	1,909	2%	8,508	3%
Queensland	52,055	24%	35,318	40%	87,373	29%
South Australia	12,021	6%	3,973	4%	15,994	5%
Tasmania	7,589	4%	1,477	2%	9,066	3%
Victoria	39,201	18%	16,414	19%	55,615	18%
Western Australia	22,309	10%	5,994	7%	28,303	9%
Total by State and Territory	216,320		88,445		304,765	

Source: STR

- Queensland, widely considered the domestic holiday destination of Australia ranks second in the number of accommodation rooms in Australia. Unlike New South Wales and Victoria, a large portion of visitors were outside of the capital city. Queensland continues to house the highest number of serviced apartments, comprising 40% of the total Australian Market for the year ending June 2021⁵, with the hotel market not yet as established as NSW.
- Victoria ranks third by total accommodation; however, does contain the highest number of rooms under construction. 65% of existing accommodation rooms are in Melbourne³ with the remainder located in regional areas.

UNDERLYING DEMAND FACTORS AND IMPACT OF COVID-19



INTERNATIONAL TRAVEL



DOMESTIC TRAVEL



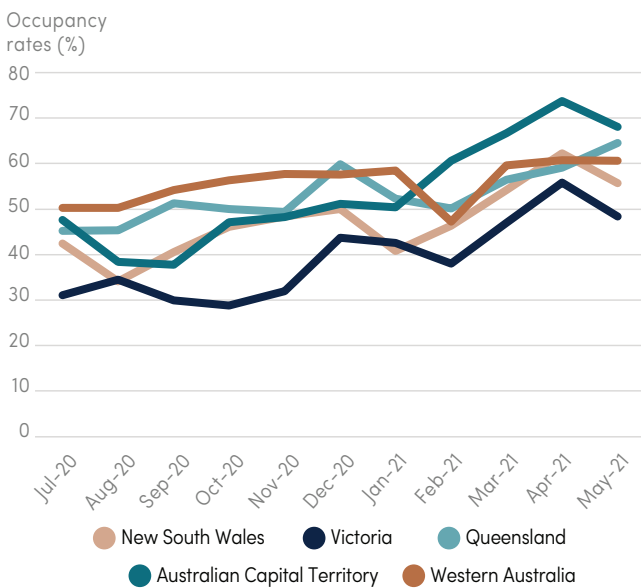
CONSUMER SENTIMENT



NATIONAL PLAN AND STATE BORDERS

HOTEL PERFORMANCE FOLLOWING COVID-19

FIGURE 1: AUSTRALIAN MAJOR HOTEL MARKETS – AVERAGE OCCUPANCY RATES FOR FINANCIAL YEAR 2021



Source: STR

Perth and Brisbane markets previously dodged lockdowns, contributing to the maintenance of occupancy behind closed borders. In contrast, and despite quarantine business, Melbourne and Sydney occupancy was impacted by lockdowns.

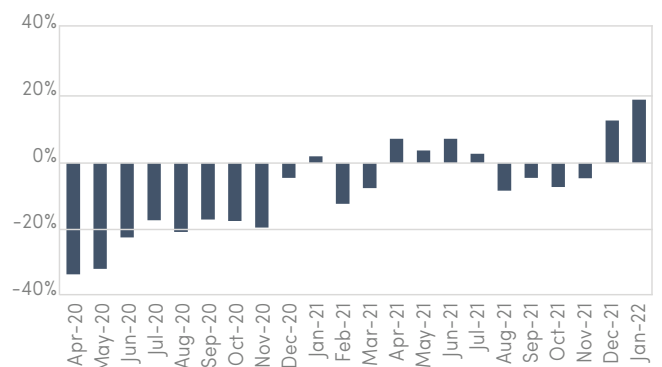
Year-to-date December 2021 revenue per available room has seen significant improvement over its previous period of 2020. Darwin and the Sunshine Coast have seen the greatest improvement and are two major markets which have exceeded their 2019 'pre-covid' performance.

FIGURE 2: REVPAR PERFORMANCE SNAPSHOT - 2021

	YTD DEC 2021 VS YTD DEC 2020	PERCENTAGE OF 2019 LEVEL
Brisbane	31.5%	83%
Canberra	21.3%	60%
Darwin	157.9%	116.5%
Gold Coast	46.7%	84.3%
Hobart	52.8%	79.5%
Melbourne	-19.5%	38.4%
Newcastle	29.3%	78.7%
Perth	30.6%	81.8%
Sunshine Coast	56.1%	107.1%
Sydney	-7.6%	40.6%

Source: STR, Horwath HTL December 2021 Quarterly Hotel Market Outlook

FIGURE 3: ADR % CHANGE TO 2019, APR 2020 – FEB 2022



Source: 2022 STR, LLC / STR Global "STR", 2022 CoStar Group

The Australian hotel industry showed resilience in 2021, following the substantial shocks to demand in 2020 resulting from the pandemic. Apart from Melbourne and Sydney, which posted slight declines in YOY annual RevPAR, all major Australian cities posted YOY growth on annual RevPAR (Figure 2). This reflects the general trend of 2021 which saw states that rely heavily on international and interstate travel (Victoria/New South Wales) suffer more than those that rely more on intrastate travel (Western Australia).

According to Deloitte, total international and domestic expenditure losses since the beginning of the pandemic until June 2021 reached \$106 billion relative to expenditure levels prior to covid. International tourism represents over 50% of this loss (\$56 billion). As state border closures and lockdowns continued, domestic travel also faced headwinds and contributed \$50 billion towards the above-mentioned losses (\$38 billion from overnight travel and \$12 billion from day trips).

Despite these large losses the industry showed early signs of recovery through the first half of 2021 as restrictions began to ease in most states (Figure 1). Though year-on-year ADR growth demonstrated pricing resilience prior to the July 2021 lockdowns of New South Wales and Victoria the emergence of the Delta and Omicron variants over the second half of 2021 halted momentum of the recovery over the rest of the quarter. ADR growth's dependence on open state borders and unrestricted travel within Australia was demonstrated by the rebound in the first quarter of 2022, where restrictions eased for the two major east-coast markets.

The regional/leisure market has outperformed its capital city peers and has accelerated beyond pre-pandemic levels. The traditional capital cities markets, which have historically been the top performers in the industry, have lagged behind regional markets as business travel levels have decreased and consumers look to escape crowded city centres.

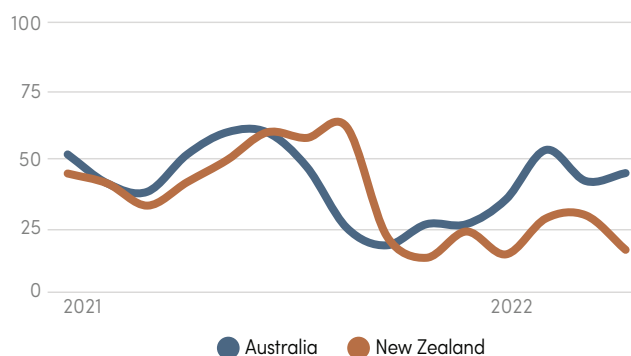
Despite the difficult trading conditions of the past two years, demand for assets in the sector has remained strong with institutional investors eyeing market entry opportunities and purchasers looking to take advantage of potential discounts or conversion opportunities. More recently, hotels are being looked at as a hedge against inflation due to the ability to price daily as opposed to other commercial real estate which typically prices rents on an annual, or longer, basis.

INTERNATIONAL TOURISM

Australia remained mostly closed to international visitors in 2021 and the international border did not re-open to fully vaccinated visitors until February 2022.

An expansive 'travel bubble' with New Zealand was expected to provide the sector with a much needed boost in confidence and activity in the second half of 2021. However, the emergence of the Delta variant quickly halted any expansion and effectively ended the short-lived travel bubble. New Zealand travellers spent over 12 million nights in Australia and contributed \$2.5b to the economy in 2019.

FIGURE 4: OCCUPANCY (%) JANUARY 2021 TO MARCH 2022, INDEXED TO 2019



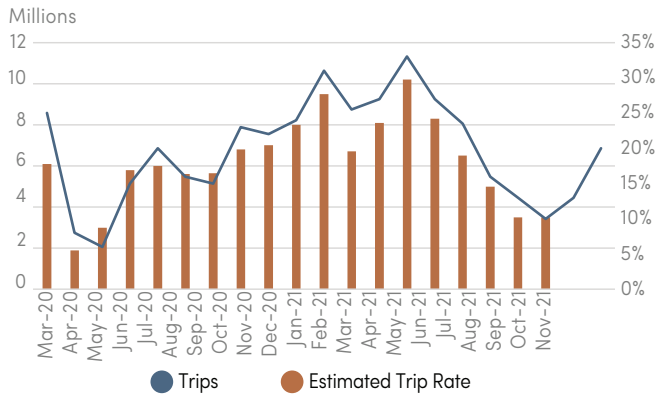
Source: e: 2022 STR, LLC / STR Global "STR", 2022 CoStar Group

The rest of 2022 is expected to be telling in terms of the speed of recovery of international travellers to Australia. It is expected the sector will not recover to 2019 pre-pandemic levels until at least 2023. However, early data from STR has shown a recent uptick in Australia's Occupancy % indexed to 2019. This uptick seems to coincide with the February 2022 international border opening.

DOMESTIC TRAVEL

Domestic tourism in Australia has experienced declines in both the number of trips and dollar spend since the start of the pandemic. As shown in Figure 4, the sector began to recover in the H2 2020 and H1 2021. However, progress was halted by various Delta variant outbreaks around the country ultimately leading to strict and lengthy lockdowns in Melbourne and Sydney. The reinstatement of border closures and health regulations led domestic tourism numbers to fall again in the September quarter 2021⁶.

FIGURE 4: DOMESTIC OVERNIGHT TRIPS AND TRIP RATES MARCH 2020 TO NOVEMBER 2021



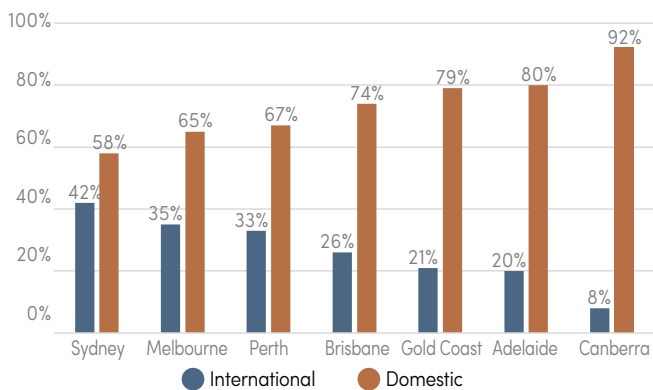
Source: Tourism Research Australia – Travel By Australians, September Quarter 2021

The reopening of state economies as vaccination rates increased coupled with a fall in recorded COVID cases, allowed for the progressive easing of lockdown restrictions starting from October 2021. The December quarter 2021 is expected to provide additional promise with domestic overnight trip rates forecast to show further signs of recovery (Figure 4). While data is not yet available, this trip rate was expected to continue to improve due to additional easing of restrictions coinciding with the holiday season.⁷

The domestic travel sector is expected to continue to be segmented between regional locations and capital cities. International border restrictions forced Australians to travel domestically and directly benefitted regional locations. It remains to be seen how this

Now that state borders are open and restrictions eased, capital cities are expected to benefit from workers return to the office driving more domestic business travel and an increase of activity in CBDs.

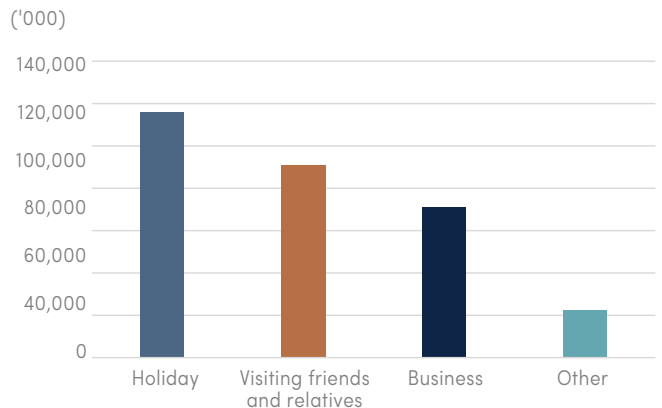
FIGURE 5: DOMESTIC VS INTERNATIONAL SHARE OF VISITOR NIGHTS IN AUSTRALIAN ACCOMMODATION REPORTED AT MARCH-2020



Source: CBRE – Asia Pacific Real Estate Market Outlook 2021 – Australia – Hotels, Tourism Research Australia March 2020

- Historically, when compared with other Australian cities, Sydney and Melbourne have predominantly experienced a higher proportion of international travellers as these cities are well recognised as being the gate-way international cities. We do expect domestic travel to increase to these cities, however due to the greater reliance on international travel, we see the hotel market recovery in Sydney and Melbourne lagging behind other cities.
- Other Australian cities, especially those in Queensland, are largely driven by domestic travel. With the current restrictions on international travel, the Brisbane and Gold Coast markets are expected to receive an influx of domestic travellers and perform strongly throughout 2021, with evidence of this already being seen in Q4 2020 and early 2021, as occupancies in Brisbane returned to above 50%.
- Pre-COVID (2019) domestic travel overnight spend represented \$78.6bn⁸ and 60%⁹ of total visitor nights, and now that Borders are re-opened, we expect to revert to this position again in 2023-2024.

FIGURE 6: NUMBER OF NIGHTS BY STOPOVER REASON FOR YEAR ENDING SEPTEMBER 2020



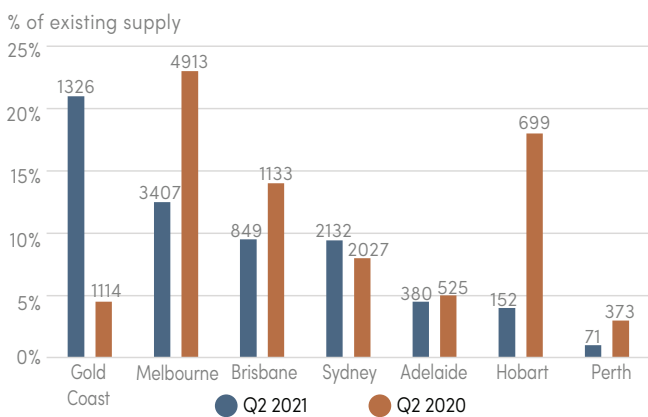
Source: : Tourism Research Australia (Sep-20)

- Holidays (39%) remained the most common reason for domestic travel throughout the year ending September 2020, followed by visiting friends or relatives (30%) and business travel (24%) – Figure 6.
- We expect ‘visiting friends and relatives’ to pick up as borders have now opened, with domestic holidays to also rebound well. Business travel is expected to improve, however, it is anticipated that this will be dampened by the increasing popularity of online conference calls, that have become more commonplace following the pandemic.

- Intrastate travel over the past year represented 65% of all domestic travel, reflecting increasing regional travel by Australians, subsidised by the state governments and lack of available international travel. These incentives have continued through early 2021, providing a boost to regional tourism across Australia.
- Overall, interstate visitors travelled to NSW (30%) most frequently, followed by Queensland (24%) and Victoria (18%).⁷

HOTEL SUPPLY PIPELINE

FIGURE 7: NEW SUPPLY PIPELINE (UNDER CONSTRUCTION) INCREASE RELATIVE TO EXISTING INVENTORY



Note: labels represent the number of rooms under construction (only)
Source: CBRE Research (Q2 2021, 2020)

Australia is currently on the tail end of a hotel development boom, with the upcoming calendar year setting the stage for a large number of projects launch. As a result, supply percentage growth is expected to see a national peak toward the end of this year and into 2023. This has been further exacerbated as potential projects have been put on hold due to the pandemic and under construction projects have or are nearing completion.

Prior to Q1 2020 hotels were trading at record levels of occupancy, particularly in Melbourne where there were markets that had supply constraints. 2021 saw significant new stock delivered, around particularly along Australia's eastern seaboard. CBRE estimate that there are a further 8,300 rooms still under construction this is heavily concentrated in Gold Coast and Melbourne (see Graph 7). Based on a percentage of existing available rooms, the two boast the highest of all states. Compared to the preceding year ending 2020, confidence in these markets

have increased through the pandemic period, particularly demonstrating the strong domestic demand for the Gold Coast destination.

Though intra and interstate travel become popular alternatives to international destinations and large performance gains are being realised within regional locations, only 10% of projects in final planning or under construction phases are considered regional.¹⁰

The bulk of rooms under construction continue to be skewed toward the Luxury and Upscale class of accommodation product, traditionally being the relied on as a staple of corporate travel on the eastern seaboard of Australia.

Across Australia, ~21,000 new accommodation rooms have been delivered from the year ending June 2020 to the year ending June 2021.¹¹ 25% of this stock was located in Victoria, largely comprised of hotels and resorts, and serviced apartments in the luxury/upper and middle-class product category. Notable accommodation openings in Melbourne include W Hotel, Melbourne (294 guest rooms) and Melbourne Marriot, Docklands (189 guest rooms).¹² Such accommodation rooms are marketed and include upscale amenity, demonstrating supply increasing to meet the demand for the product type.

SECTOR OUTLOOK

While lockdowns and travel restrictions over the past two years have been harmful to tourism activity, Australia's abandonment of a zero COVID approach has renewed cautious optimism of a recovery. The Federal and State Governments new plans to live with the virus remained consistent despite being tested by the emergence of the Omicron variant in December 2021.

Growth in visitation is expected for the rest of 2021-22 and is forecast to continue through 2022-23. Domestic tourism is forecast to return to an average pre-pandemic level in 2022-23, and to surpass its 2018-19 peak the following year. A more moderate growth trajectory is forecast for the period between 2023-24 and 2025-26.¹³

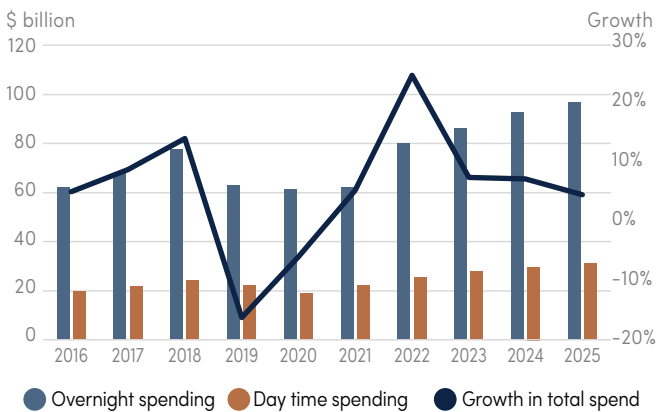
The intensity of the expected short-term recovery in domestic tourism is emphasised by several factors including:¹⁴

- reopening of state borders
- declining risk of lockdowns
- pent-up demand for travel
- accrued leave and disposable income during lockdowns

- incentivisation from government travel subsidies and support payments
- marketing by the tourism industry and consumer confidence

Whilst international travel is not expected to return to pre-covid levels for a few years, local domestic travel is expected to increase, partially offsetting the reduction in foreign tourism.

FIGURE 8: DOMESTIC VISITOR EXPENDITURE ON OVERNIGHT AND DAY TRIPS



Source Domestic Tourism Forecasts 2021-22 to 2025-26, Tourism Research Australia, Austrade, Canberra.

Austrade modelling suggests that overnight visitor expenditure will reach \$80.2 billion and day trip expenditure will reach \$25.5 billion in 2022-23 (Figure 3), indicating that tourism expenditure is expected to recover quickly, showing figures at pre-pandemic levels.

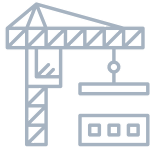
Australian domestic visitor expenditure is likely to grow by 5.9 per cent on average in each of the two years from 2023-24, to reach \$127.7 billion in 2025-26.¹⁵

It remains to be seen if regional locations will continue to benefit from increased domestic travel or if the segment is currently enjoying a sugar spike and will eventually return closer to pre-pandemic levels as international travel returns. Markets such as Gold Coast and Brisbane are expected to continue to mature and benefit from increased infrastructure spending ahead of the Brisbane 2032 Olympics.

Australia’s gate-way cities (Sydney and Melbourne and Brisbane to a lesser extent) are expected to benefit from increased international travel over the short to medium future as well as the return of business travel.

Consumers are expected to continue to demand higher levels of hygiene and service standards resulting in the underperformance of serviced apartments and short-term rental accommodation. Accordingly, we continue to expect new hotels to perform well across the country.

COMMERCIAL REAL ESTATE DEBT OPPORTUNITIES



Construction periods of 18 – 24 months, expected to alleviate immediate occupancy risk



Strong risk-adjusted opportunities for well-structured debt



MaxCap will continue to conduct thorough due diligence on potential hotel deals

Despite the challenges of 2020 and 2021, MaxCap remains cautiously optimistic regarding commercial real estate debt opportunities within the hotel sector.

In particular, MaxCap continues to observe the retreat of the major banks from property construction lending generally and for hotels specifically, and accordingly sees an increasing number of attractive risk-adjusted opportunities.

Selective participation in these transactions continues to be carefully considered, with preference for those transactions benefiting from the following favourable risk-return characteristics:

Mixed use income diversification

In line with pre-pandemic times, MaxCap views mixed use hotel projects (that comprise other components such as residential apartments or commercial tenancies) more favourably than standalone hotels.

The variety of assets within the project provides natural diversity, leading to reduced investment risk. Moreover, the non-hotel components of the project provides the developer with the ability to obtain presale and/or pre-lease commitments, which further de-risks the project. Additionally, should the project be partially presold (if for example there is a residential component), settlements from pre-sales would reduce the residual LVR, enhancing the exit position of the overall project/asset.

Opportunistic return out-performance

Transactions where, as a result of dislocation of the banking sector reducing the supply of credit, MaxCap is able to generate significant outperformance in returns for a given level of risk.

Consistent with this thematic, MaxCap is aware of several earmarked hotel developments which are expected to commence construction in the next 12 months. These developments are predominantly underpinned by long term hotel management agreements with global hotel operators, who remain heavily invested in the Australian market and who appear to be confident in Australia's handling of the pandemic to date.

As construction periods are typically 18 to 24 months for a major hotel project, the near terms risks are also expected to be largely alleviated by the time construction completes and +domestic travel resumes and some international travel bubbles open.

Noting the unsaturated supply in along the East Coast (particularly Melbourne and Gold Coast stock), MaxCap expects to see strong risk-adjusted opportunities appear in the non-bank space, across multiple locations in Australia for well-structured debt investments and will continue to be selective of high-quality sponsors who have a demonstrated track record.

ENDNOTES

- 1 Tourism Research Australia: International and Domestic Visitor Survey Results September 2021
 - 2 Tourism Research Australia: International and Domestic Visitor Survey Results September 2021
 - 3 Tourism Research Australia: International and Domestic Visitor Survey Results September 2020
 - 4 <https://www.traveller.com.au/worlds-busiest-flight-routes-2021-sydneymelbourne-route-back-among-worlds-busiest-h1vcm8> - Accessed March 2022
 - 5 Australian Accommodation Monitor 2020 – 2021 Report Summary
 - 6 Tourism Research Australia Travel By Australians – September Quarter 2021
 - 7 Tourism Research Australia Travel By Australians – September Quarter 2021
 - 8 Tourism Research Australia: Domestic Visitor Survey Results September 2020
 - 9 Tourism Research Australia: International and Domestic Visitor Survey Results September 2019
 - 10 STR. Copyright 2022 CoStar Group
 - 11 Australian Accommodation Monitor 2019 – 2020 & 2020 – 2021 Report Summaries
 - 12 <https://www.newhotelsopening.com/new-hotels-in-melbourne.html> - accessed April 2022
 - 13 Domestic Tourism Forecasts 2021-22 to 2025-26, Tourism Research Australia, Austrade, Canberra.
 - 14 Domestic Tourism Forecasts 2021-22 to 2025-26, Tourism Research Australia, Austrade, Canberra.
 - 15 Domestic Tourism Forecasts 2021-22 to 2025-26, Tourism Research Australia, Austrade, Canberra
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