AUSTRALIAN HOTEL INVESTOR SENTIMENT SURVEY

5TH EDITION

February 2021

Colliers

Welcome to the fifth Colliers Australian Hotel Investor Sentiment Survey. The survey was launched in response to the global COVID-19 health pandemic and is designed to reflect the opinion and intentions of the Australian hotel investment community.

Colliers' Australian Hotel Investor Sentiment Survey seeks to identify future trends in the Australian hotel and tourism sector to assist with planning for the recovery.

The February 2021 edition includes investor sentiment for future trading across geographies and segments and compares the extent to which sentiment has changed. It also provides a benchmark position on key investment metrics and short-term strategies being targeted by investors. As we enter the second year of the health pandemic in Australia, we revisit some of the questions we posed at the start of the crisis to understand how sentiment for the sector has evolved.

We trust you find the Australian Hotel Investor Sentiment Survey an insightful read and, as always, we welcome your feedback on how we can improve and any questions you would like to see reflected in future surveys. We will continue to circulate this survey every quarter to track the shift in sentiment as we navigate the recovery through 2021.

Gus Moors
Head of Hotels

Karen Wales
National Director, Hotels

Introduction

Australia experienced a deterioration in travel confidence over the past three months with the effective cancellation of the peak summer holiday season and the ongoing complexities of snap lockdowns and state border closures.

With the rollout of the vaccine across the country having commenced, a consistent national health strategy is now required which recognises and contains virus outbreaks without the closure of state borders. The resumption of domestic travel is vital to the recovery of Australia's biggest economic powerhouse, our cities. PwC estimates that gross value add generated by the Sydney, Melbourne and Perth CBD is $165 billion, more than the mineral and resources industry (at $161 billion) and employing 3.5 times as many people as in the mining sector.

In February 2021 the Australian Government extended the extension of the human biosecurity emergency period and closure of international borders until mid-June citing the emergence of more highly transmissible variants of COVID-19 overseas. Whilst not unexpected, the extension will make it 15 months that Australia's borders have been shut to the rest of the world, and citizens banned from leaving, unless they seek an exemption.

This decision also confirms that hotel quarantine will be in place until at least the middle of 2021 and with expectations that it could remain for the rest of the year. Whilst providing respite to some hotel owners, a clear national plan is now required to opening the international borders which recognises the importance of lifting the caps on returning quarantine travellers and commencing international student pilots, as well as opening up overseas markets subject to rigorous risk assessment and the investment in nationally consistent health measures of the borders.

The Australian Government's $1.2 billion tourism support package announced in March 2021 excludes Australia's major cities of Sydney and Melbourne and the main point of entry for international visitors. While the industry welcomes any financial support from government, the Australian Government should be investing in cities and regions equally if the tourism industry is to fully recover.

Highlights of the Survey

1

Investor sentiment for hotel trading in Australia highlights the uphill struggle the sector now faces following the effective cancellation of the peak summer holiday season and the closure of international borders until mid-June 2021. Sentiment for trading in H1 2021 has declined to be at the lowest level since the start of the crisis at -31.3 per cent and with expectations turning only slightly positive for H2 2021 at 2.0 per cent.

2

Sentiment for medium term trading also lags prior surveys with expectations weighted in favour of positive trading in 2022 of 40.2 per cent. This compares to 73.4 percent in our April 2020 survey and a peak of 75.6 per cent in our August 2020 survey. It is imperative for the future sustainability of Australian tourism industry that governments provide a road map for the sustained reopening of borders now that vaccines are being administered.

3

Investors expect the domestic leisure segment to continue to underpin the sector in the short term with sentiment weighted in favour of positive trading of 32 per cent in Q2 2021 increasing to 56.0 per cent in Q3 2021. This is considerably lower than in our November 2020 survey when positive sentiment was 60 to 70 per cent.

4

Investors expect the timing of recovery for all other segments to be pushed back by at least another six months with sentiment for corporate travel weighted only slightly in favour of positive trading from Q2 2021. Conversely MICE and Group travel are expected to remain negative until Q4 2021.

5

The corporate recovery is not expected to gain pace until 2022 when investors expect positive trading to surpass the leisure segment, albeit only marginally. Investor expectations for trading in 2022 are 73.9 per cent for the domestic corporate segment and 72.0 per cent for domestic leisure travel.

6

The next quarter presents as very challenging for the major accommodation markets with sentiment weighted in favour of negative trading in Melbourne and Perth at -12.5 per cent and 6.7 per cent respectively with a track record of snap lockdowns and swift border closures by state governments. Investors remain optimistic that Melbourne will recover by 2022 but trading in Perth is expected to continue to lag.

7

Sydney is expected to see the greatest trading upswing with the Harbour city ranked highest for positive trading from Q3 2021 and reaching a pinnacle in 2022. Every time restrictions have been eased, it has been another shot of confidence for the NSW economy and this is being reflected in investor sentiment for hotel trading.

8

Our February survey indicates little change in cap rate expectations at the national level but with a growing disparity in expectations between segments and geographies. Arguably we are now at an inflection point with investor expectations for cap rates in the major cities softening by a further 15 basis points but tightening in the secondary cities by 40 basis points.

9

Investor expectations for hotel cap rates averaged 6.71% across all ten accommodation markets and are lowest for Sydney (5.63%), Melbourne (5.88%) and Canberra (6.27%). Canberra has shown a resilience over the past year which is increasingly attracting the attention of investors.

10

Australia's investment market is expected to ramp up in 2021 with an availability of stock past a development phase. Hold sentiment still ranks highest (43.9 per cent) but with a notable downward trend over the past six months, offset by higher intentions to Sell (17.3 per cent) and to Build (9.4 per cent). With sales activity expected to increase as the year progresses, investors are signalling that now is the time to exit, ahead of the predicted deleveraging cycle.

11

Sell sentiment is highest for Cairns, Hobart and Adelaide with all three ranking well above the Australian average whereas Brisbane and Sydney are the most highly sought for acquisitions. Canberra, Gold Coast and Perth are most favoured to hold.

12

Our spotlight section revisits some of the questions we posed at the start of the crisis and highlights how the ongoing closure of state and international borders has augmented the magnitude of the crisis for Australia's hotel and tourism sector. Almost half of investors expect to see city hotel capital values decline by 0-10% by the end of 2021 but with a further 40 per cent expecting a greater decline of more than 10%.

Trading Performance

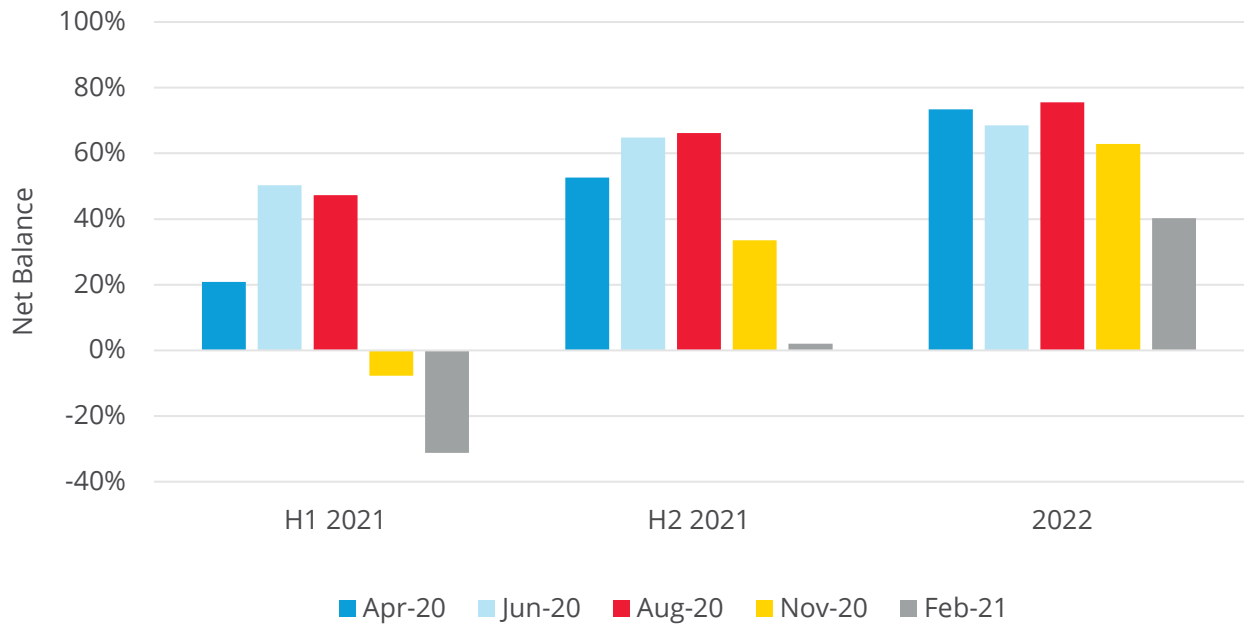
Trading performance expectations reflect investor's forward expectations as at February 2021 with reference to Q4 2020.

Results are presented as a net balance score in line with the weight of opinion with a maximum score of + or – 100% indicating that all respondents have given a positive or negative response respectively and with more information included in the methodology.

TIMING AND DRIVERS OF THE RECOVERY

The positive overtones from the containment of the virus and arrival on Australian shores of the vaccine, as well as the continued relaxation of social distancing measures, have not been sufficient to ignite improved sentiment for Australia's hotel sector with investors still expecting negative trading over the next six months.

Investor Trading Performance Expectations – Timing of the Recovery by Survey Date

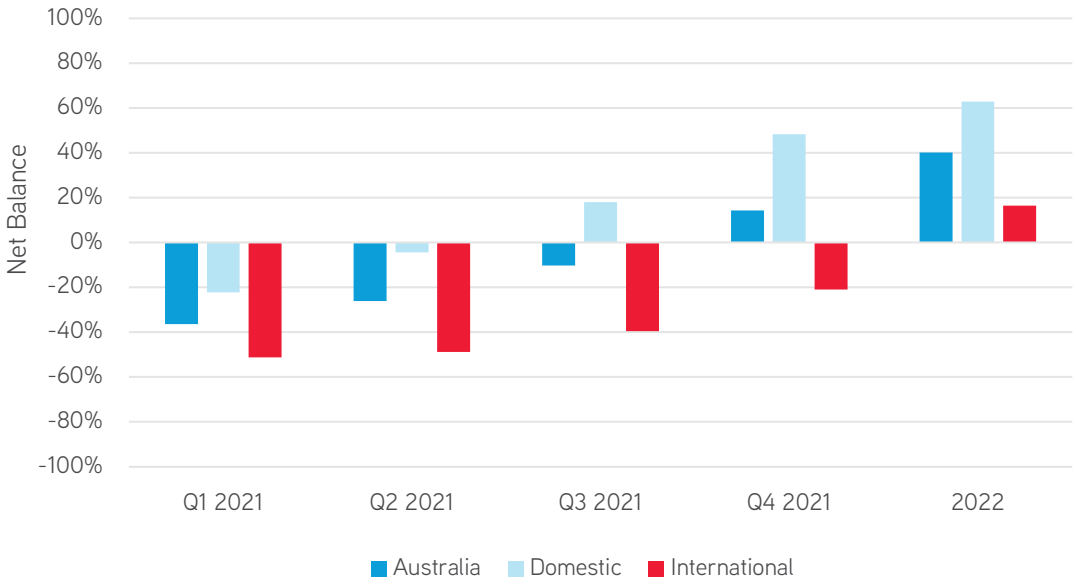


Source: Colliers Australian Hotel Investor Sentiment Survey, weighted by the number of responses

Sentiment for trading in H1 2021 and H2 2021 have declined considerably since our November 2020 survey to be at -31.3 per cent and 2.0 per cent respectively and highlights the negative impact that snap lockdowns and state border closures are having on hotel trading sentiment.

Sentiment for medium term trading also lags prior surveys with positive sentiment for Australia averaging 40.2 per cent in 2022 and a reduction of more than 20 basis points when compared to our November 2020 survey.

Summary of Investor Trading Performance Expectations – Q1 2021 to 2022



**Note: Weighted by the number of responses, Source: Colliers Australian Hotel Investor Sentiment Survey*

TRADING SENTIMENT BY SEGMENT

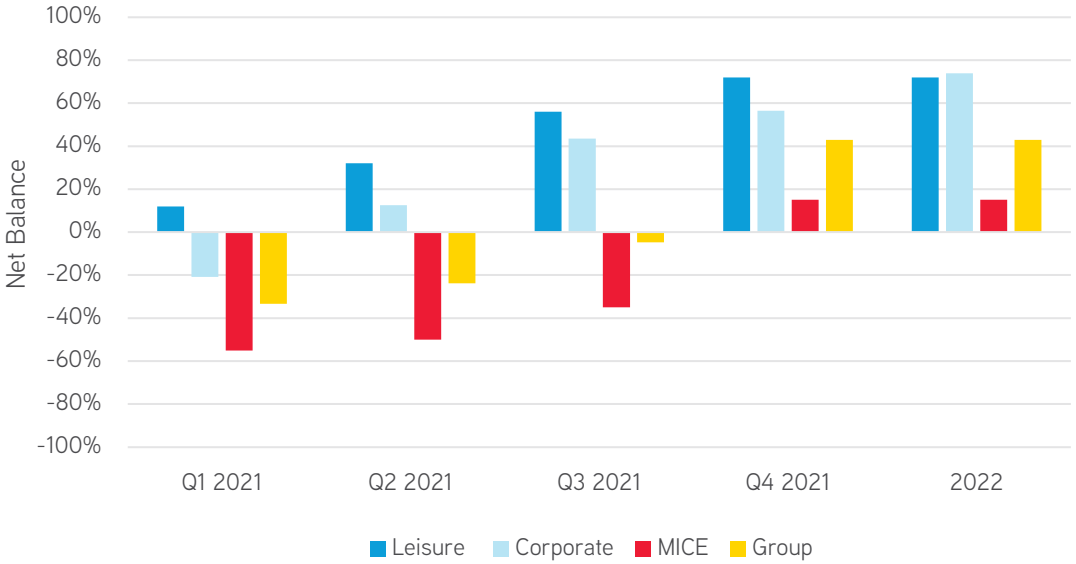
With international tourism expected to remain largely negative over the coming year, our analysis once again focusses on the domestic segment.

The domestic leisure segment will continue to underpin the recovery through 2021 before giving way to the corporate powerhouse in 2022. However, the hole in hotel revenue from disappearing corporates will be hard to make-up through 2021. While there will be pent up demand for leisure travel which could lead to a near term spike, travel will be limited to weekends and peak holiday times and the resultant reduction in hotel revenue will pose challenges.

Sentiment for trading for the corporate segment is now expected to only turn slightly positive from Q2 2021 at 12.5 per cent with the rollout of the vaccine and a slow return to normalcy for office workers. Current expectations indicate that the full corporate recovery will not take hold however until 2022 once CBD office occupancy and conditions in the labour market have stabilised.

Sentiment for trading for the MICE and Group segments on the other hand remains negative until Q4 2021. Broadly, this represents a six-month delay when compared to our November 2020 survey and highlights how momentum stalled following the December State lockdowns.

Investor Trading Performance Expectations for Domestic Tourism – by Segment, Q1 2021 to 2022



**Note: Weighted by the number of responses, Source: Colliers Australian Hotel Investor Sentiment Survey*

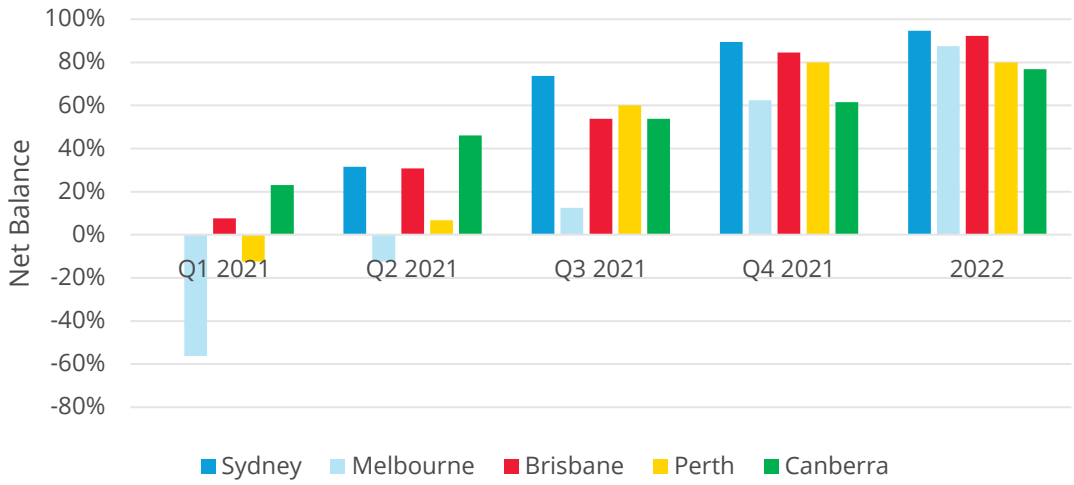
TRADING SENTIMENT BY GEOGRAPHY – MAJOR MARKETS

The next six months present as challenging for the major accommodation markets, particularly Melbourne and Perth with trading expected to remain very weak with a track record of snap lockdowns and swift border closures by state governments. Investors remain optimistic that Melbourne will recover by 2022 but trading in Perth is expected to continue to lag given the city's relative isolation and the state government's growing inward focus.

The Property Council of Australia's most recent survey of building owners and managers highlights how Melbourne and Perth CBDs both had less workers at the end of February than they had at the end of January. Melbourne's CBD recorded only 24% occupancy in the final week of February. Survey respondents identified worker preferences for greater flexibility as the main barrier to achieving full occupancy, as well as government lockdowns and public health restrictions.

Conversely Sydney's CBD experienced the strongest growth in February with 48% occupancy recorded, up from 45% in the final week of January. Investors expect Sydney to see the greatest trading upswing with the Harbour city ranked highest for positive trading from Q3 2021. This compares to a net balance of 0% in Q1 2021. Every time restrictions have been eased, it has been another shot of confidence for the NSW economy and this is reflected in investor sentiment for hotel trading.

Investor Trading Performance Expectations – Major Markets Q1 2021 to 2022



**Note: Weighted by the number of responses, Source: Colliers Australian Hotel Investor Sentiment Survey*

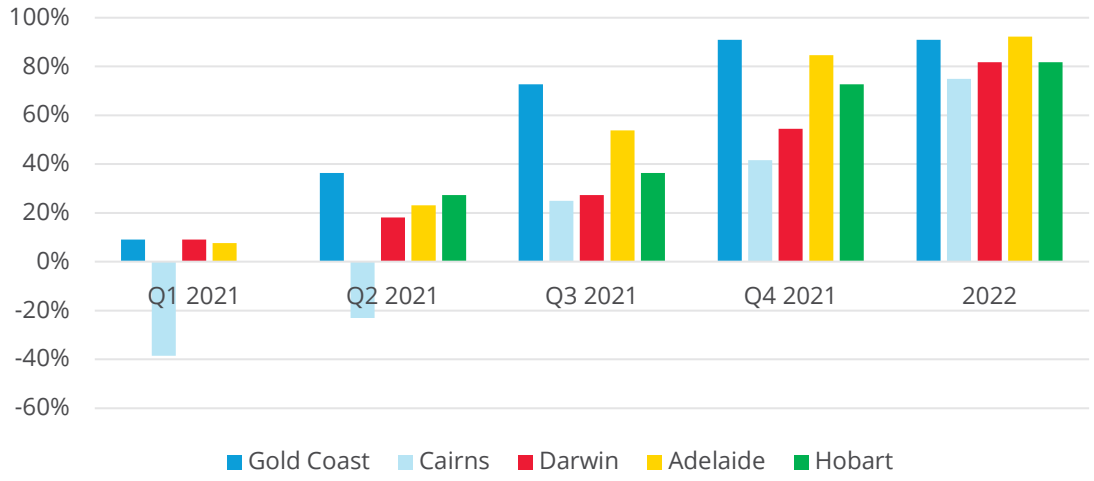
TRADING SENTIMENT BY GEOGRAPHY – SECONDARY MARKETS

Sentiment for the secondary and leisure markets is more diverse with trading in Cairns and Darwin to remain challenging throughout 2021, owing in part to the tyranny of distance.

The Gold Coast is expected to outperform with positive trading sentiment above 70 per cent from Q3 2021. The reopening of the state borders in February 2021 saw a surge in booking demand for Australia's favourite playground, particularly visitors from Sydney. The Gold Coast has also announced that it has secured its first major conference as business events recovery beckons. The Gold Coast hopes to welcome more than 1,000 delegates for the World Federation of Chiropractic Biennial Congress in March 2023.

Adelaide and Hobart are also expected to perform well with a slew of new hotels in each providing added allure to domestic travellers. Both have also been at the forefront of travel voucher schemes. The second iteration of the Great State Voucher program in South Australia kicked off in January 2021, providing $100 vouchers for travellers to spend at participating CBD and North Adelaide stays, along with $50 to use at regional and suburban accommodation. And this time, it's available to all Australians.

Investor Trading Performance Expectations – Secondary Markets Q1 2021 to 2022



**Note: Expectations are neutral for Hobart in Q1 2021, Source: Colliers Australian Hotel Investor Sentiment Survey*

Investment Metrics

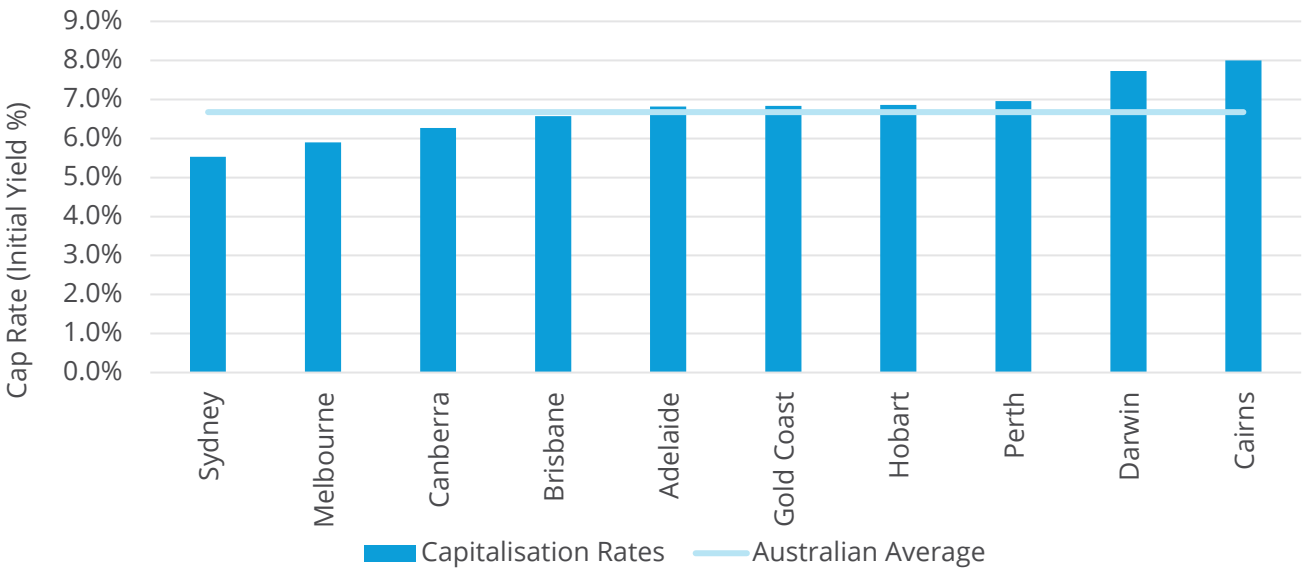
In our survey we asked investors to benchmark key investment metrics and provide a trend comparison of expectations from the surveys undertaken throughout the year.

Our survey asks investors to provide expectations for investment yields (cap rates) required to consummate a transaction for a stabilised upscale asset, excluding repositioning through capital expenditure or a new management focus. It is worth noting that these yields are those that investors are seeking whereas actual yields required to consummate a transaction may be lower.

CAP RATES

Investor expectations for hotel cap rates in Australia averaged 6.67% across all ten accommodation markets in February 2021. Investor expectations remain lowest for Sydney (5.53%), Melbourne (5.9%) and Canberra (6.27%) but with major markets recording a softening trend skewed by expectations for Perth and Brisbane. The response of the WA and QLD State Governments to arbitrarily close state borders during the peak holiday season, arguably for political gain, has brought a new level of risk to accommodation markets.

Investor Expectations for Cap Rates (Initial Yield) for a New Acquisition as at February 2021



Note: Australian average is weighted by the number of responses, Source: Colliers Australian Hotel Investor Sentiment Survey

From a practical perspective, the COVID-19 environment created challenges for updating commercial property valuations, in some instances relating to physical access, and more generally because of a high degree of uncertainty around valuation fundamentals, recent sales evidence and the market outlook.

This uncertainty was more pronounced for some asset classes and geographies which led APRA to accept the deferral of revaluations for existing commercial property assets. The deferral period was limited to 31st March 2021 however and with deferred valuations to be completed within six months after this point. This is likely to impact the hotel sector over the next six months, particularly whilst trading uncertainty prevails.

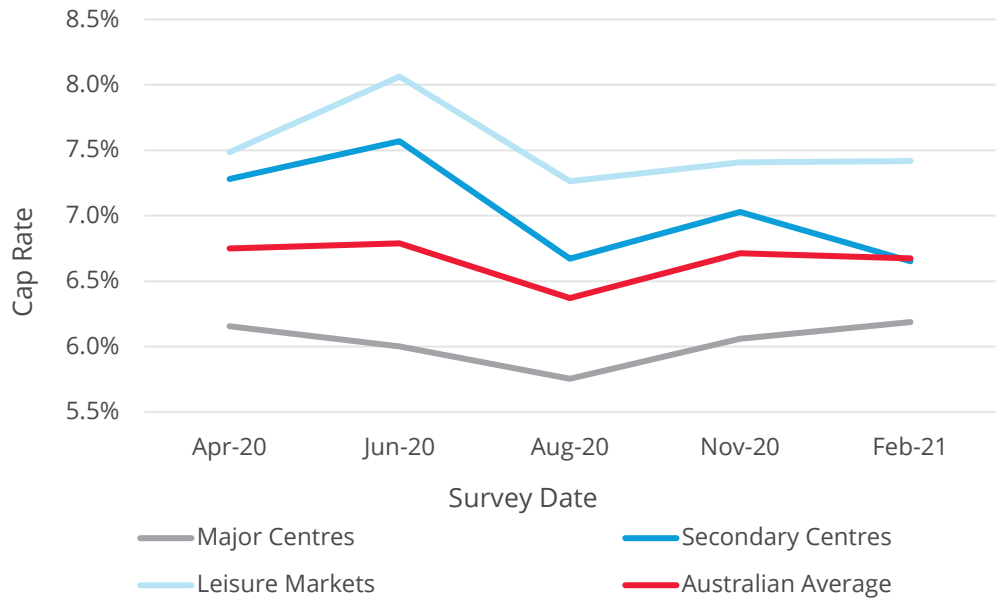
CAP RATE TREND

As noted in our prior surveys, it was hard to talk about cap rates in 2020 given the significant reduction in hotel operating income and this is expected to remain the case in 2021. Whilst broadly hotel revenue is projected to increase, net operating profit will moderate with the unwinding of supplier reliefs and government supports.

Whilst our last survey indicated a potential softening trend, consistent with what has been seen during previous crises, investor expectations for yields in February 2021 at the national level reflect little change compared to three months ago and with very little transaction evidence to indicate otherwise.

The chart below shows the Australian average cap rate trend, as well as the weighted average for the major centres (Brisbane, Melbourne, Perth and Sydney), secondary centres (Adelaide, Canberra and Hobart) and leisure markets (Cairns and Gold Coast). This highlights the current disparity between geographies and sectors within the Australian hotel investment market with expectations for cap rates in the major centres trending upwards, whilst being partially offset by a firming in expectation for the secondary centres which typically have a greater reliance on the domestic tourism segment. Expectations for cap rates in the major leisure markets reflected little change when compared to November 2020 with domestic leisure tourism expected to underpin travel activity over the coming six months.

Cap Rate Trend to February 2021



*Note: Weighted by the number of responses, Source: Colliers Australian Hotel Investor Sentiment Survey

Investment Intentions

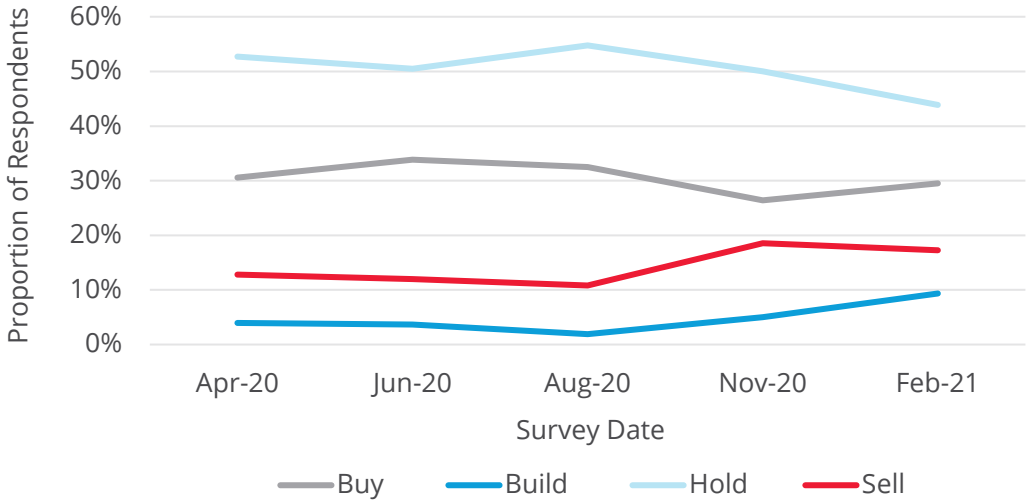
Australia's investment market is expected to ramp in 2021 with an availability of stock moving past a development phase and a weight of capital looking to invest.

Australia has sparked global interest given its management of the health crisis. The commencement of the rollout of the vaccine to a relatively small population base should cement the country's preferred investment status. The opportunity to invest in previously very tightly held key capitals is also expected to garner significant investor interest as the sector recovers.

Hold sentiment still ranks highest by investors at 43.9 per cent but with a notable downward trend over the past six months, offset by higher intentions to sell (17.3 per cent) and most recently to build (9.4 per cent). With activity expected to increase as the year progresses, some investors have signalled that now is time to exit to get ahead of the deleveraging cycle. Sophisticated investors are likely to be better positioned to secure more favourable terms on their debt facilities only once there is a clear signal that market conditions have stabilised.

Sell sentiment is highest for Cairns, Hobart and Adelaide with all three ranking well above the Australian average, whereas Brisbane and Sydney are the most highly sought for acquisitions. Canberra, Gold Coast and Perth are most favoured to hold.

Investment Intentions Trend to February 2021

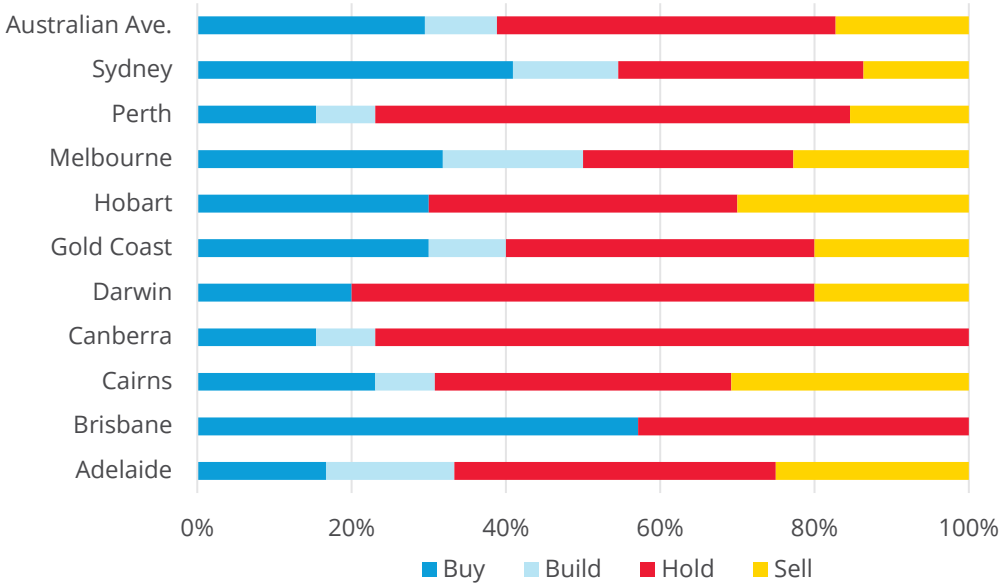


Source: Colliers Australian Hotel Investor Sentiment Survey

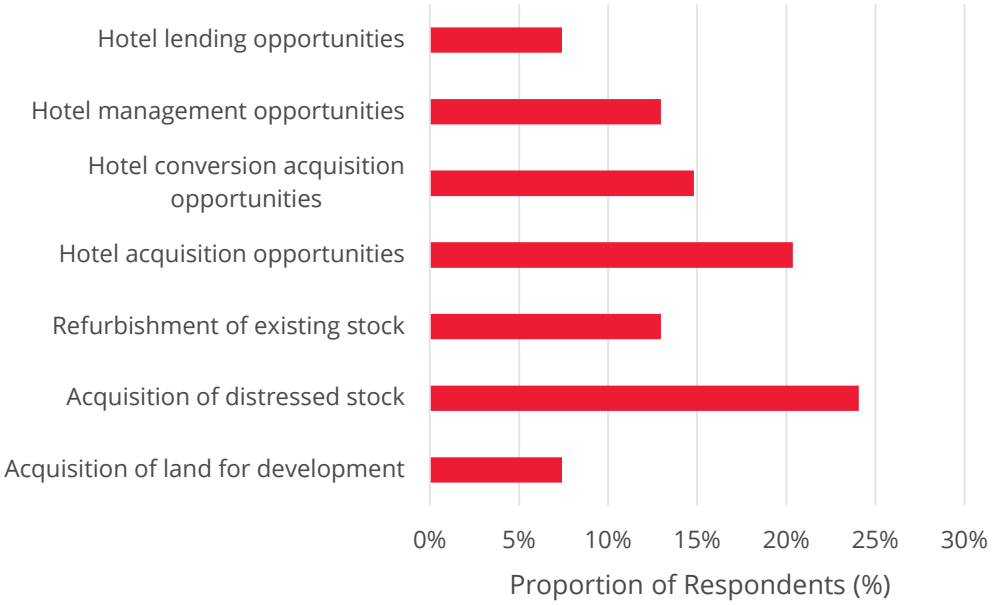
The uptick in build sentiment in our February survey defies sense but could be regarded as long-term investor confidence in the recovery of the sector. Melbourne and Adelaide ranked most highly for building despite these two markets facing some of the most significant increases in new accommodation supply in 2021.

Investors are focussed on new hotel acquisition opportunities and the acquisition of distressed stock. While banks are watching the sector carefully, there is little evidence to date that they will seek to step-in to control the assets. Instead they are understood to be encouraging an orderly sale of properties with a notable focus on portfolio rebalancing at present. As such, there may not be the deep discounts that the buy-side investors had initially expected.

Short Term Investment Intentions as at February 2021



Focus of Investment Activity as at February 2021



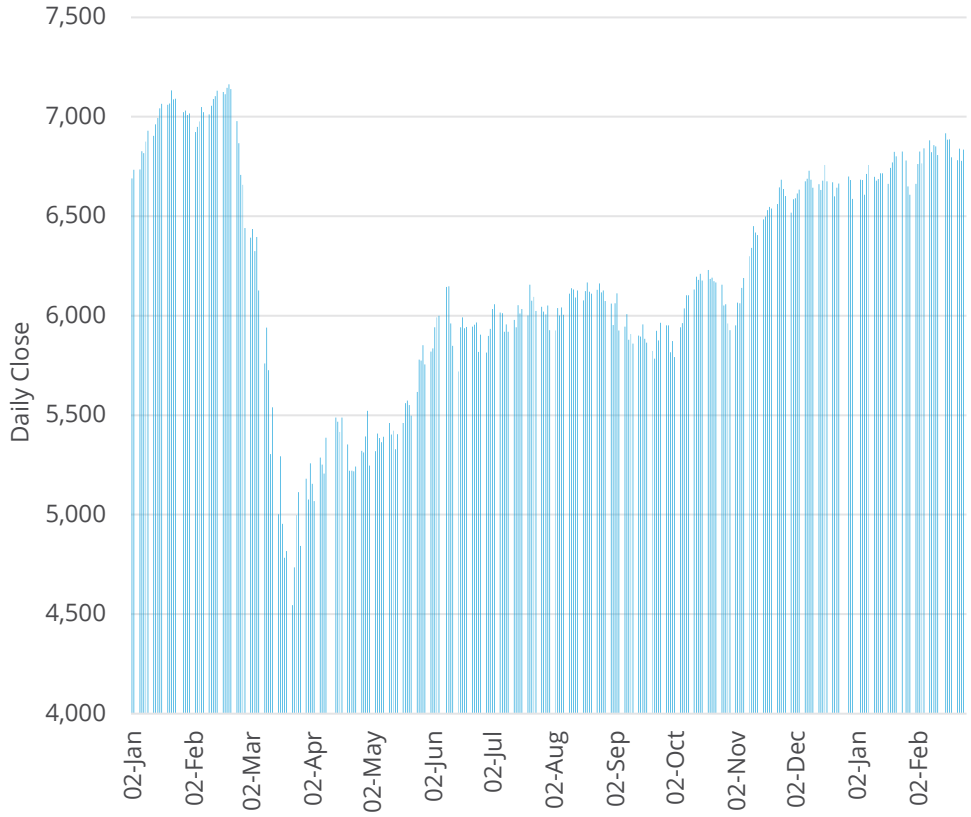
**Note: Australian average is weighted by the number of responses, Source: Colliers Australian Hotel Investor Sentiment Survey*

INVESTMENT MANDATE

In our February 2021 survey we asked investors to what extent their investment mandate had changed resulting from the global health pandemic. Interestingly only a slight majority pointed to a change in strategy with markets now being targeted most frequently reported to be Sydney and to a lesser extent Brisbane, Melbourne, Perth and Canberra. Interestingly only a handful of investors indicated that they were now actively targeting regional assets.

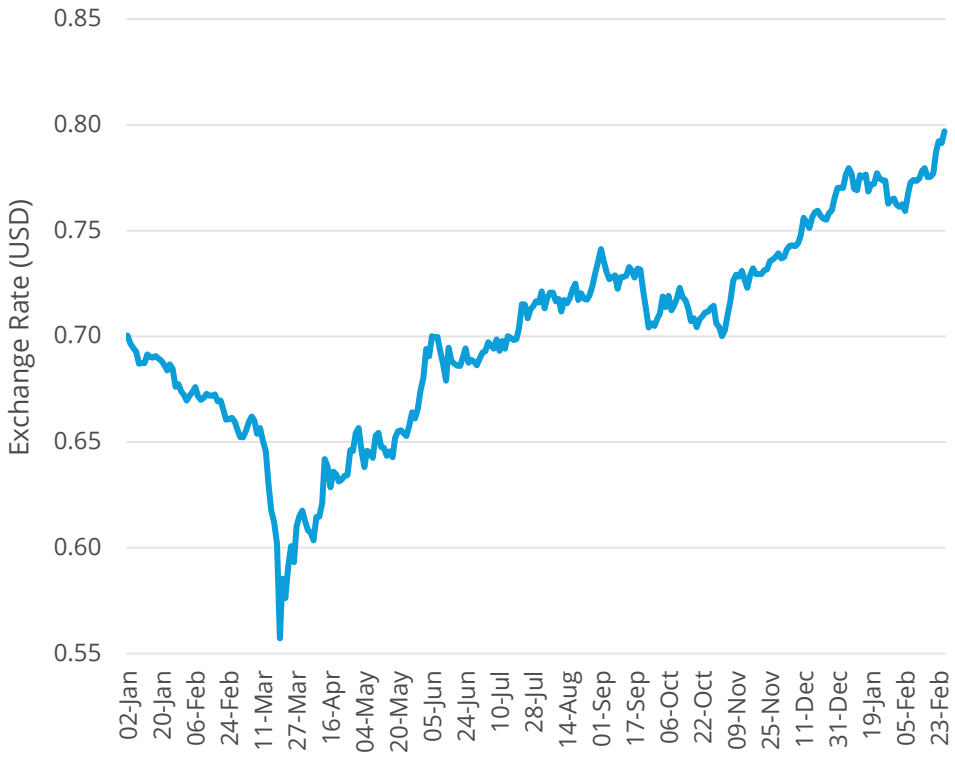
INVESTMENT INDICATORS

Australia's ASX 200 – Price Index to 26 February 2021



Source: Australian Stock Exchange, Colliers

Australian Dollar – Comparison to USD to 26 February 2021



Source: Reserve Bank of Australia, Colliers

Spotlight: COVID one year on

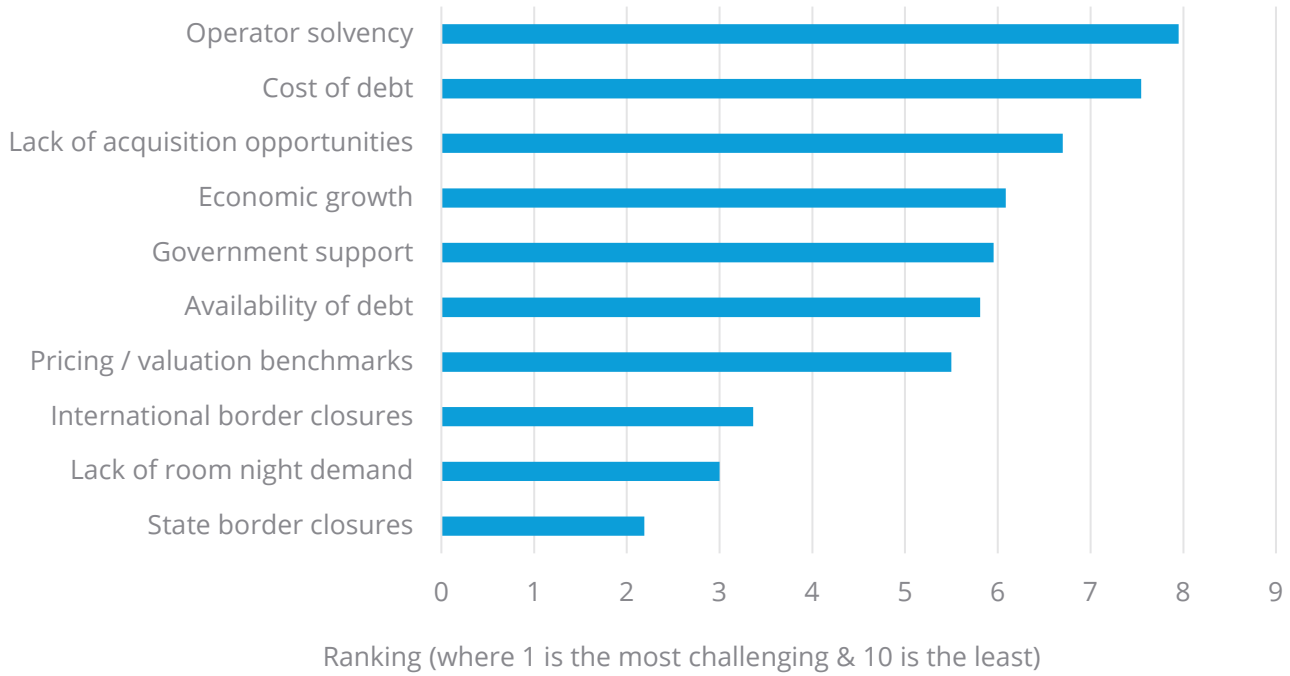
As we enter the second year of the global health pandemic in Australia, we revisited some of the questions posed at the start of the crisis to understand how sentiment for the Australian hotel sector has evolved.

THE BIGGEST CHALLENGE

At the start of the crisis, the lack of room night demand was identified as the greatest challenge facing the hotel sector at that time. This represented a marked turnaround for the sector with many Australian city hotel markets operating at record high occupancies for an extended period prior to 2020.

A year on and the lack of room night demand still rates highly, as well as the closure of state and international borders. This has resulted in a lack of clarity for the industry about the potential timing to reopen and for consumers a lack of confidence to plan, book and travel in Australia.

Challenges to the Australian Hotel Investment Market as at February 2021



Source: Colliers Australian Hotel Investor Sentiment Survey

Whilst it is widely accepted that travel into Australia is not permitted, analysis of the Australian Bureau of Statistics Overseas Arrivals and Departures data between April and December 2020 indicates that inbound travel is evident, albeit marginal, as shown in the post-COVID travel snapshot included later in this report. Whilst arrivals into Australia are predominantly returning Australians, there is a growing number of short-term visitors arriving each month and with a notable upward trend towards the end of the year.

Against a backdrop of uncertainty and indecisive policy making, pricing and valuation metrics will remain a cause for concern throughout 2021 as unlike other property assets, hotel values can experience a multiplier effect during the downward phase from a reduction in income and softening in cap rates. Previously accepted metrics are at risk should hotel trading and capital markets remain displaced for an extended period.

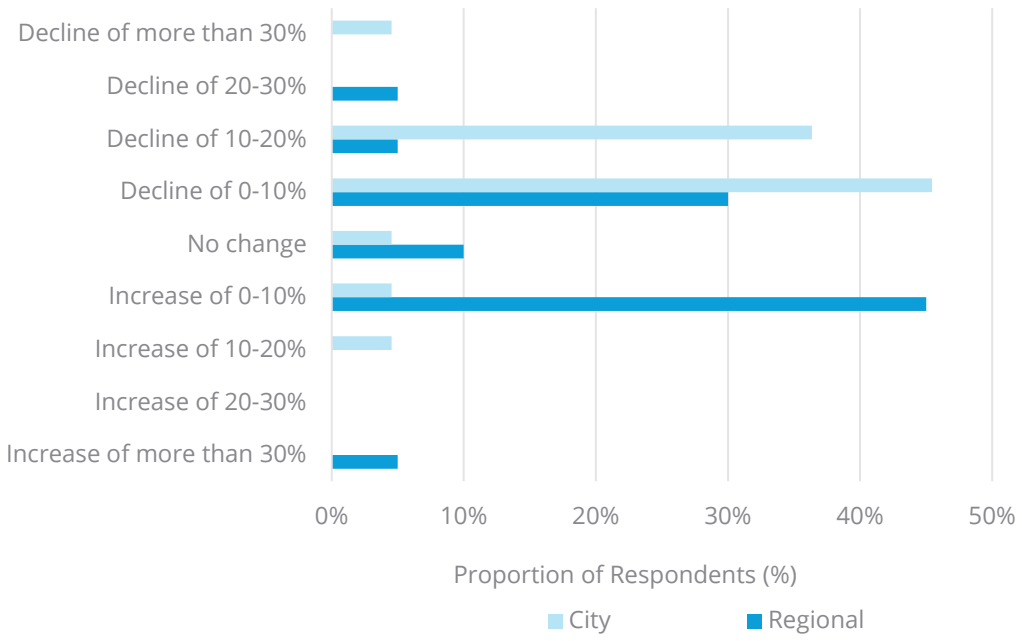
CAPITAL VALUES

We asked investors where they expect to see hotel capital city and regional values trending by the end of 2021.

Almost half of investors expect to see city hotel capital values decline by 0-10% by the end of 2021 but with a further 40 per cent expecting a greater decline of between 10% and 20%. Whilst sales evidence to date points to a decline of 5-10%, transaction evidence has been quite limited. The emergence of private equity funding for acquisitions and non-bank lenders also has the potential to cloud the rationalisation of value which is still expected to take place.

Conversely regional hotel values are expected to increase with 50 per cent of respondents expecting values to increase by up to 10% underpinned by growth in revenue and potentially increased investor demand. Options are mixed however with 40 per cent of investors expecting regional hotel values to decline which reflects the disparity between remote regional destinations and those located close to major metropolitan centres.

Investor Expectations – Change in Australian Hotel Capital Values by the end of 2021



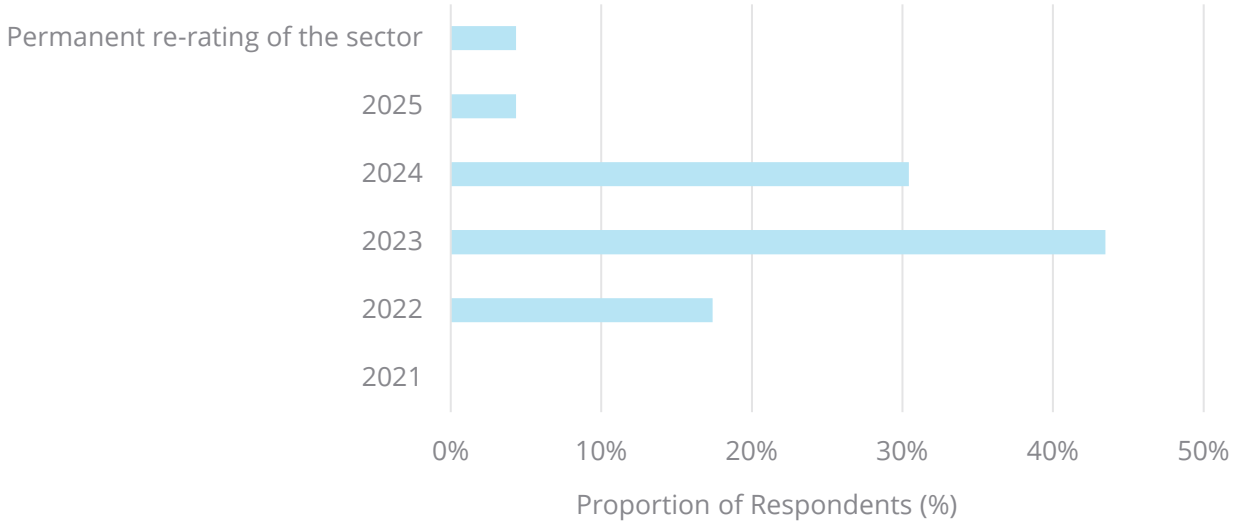
Source: Colliers Australian Hotel Investor Sentiment Survey

TIME TO STABILISATION

We asked investors how long before they expect the Australian hotel investment market to stabilise.

The majority of investor respondents expect the Australian hotel investment market to stabilise to 2019 levels in 2023 but with a further third of investors expecting the recovery to be delayed into 2024. This represents a marked change to our April 2020 survey when the majority of investor respondents expected it would take between 18 months and 2 years for the Australian hotel investment market to stabilise.

Investor Expectations – Time for Australian Hotel Investment Market to Stabilise as at February 2021

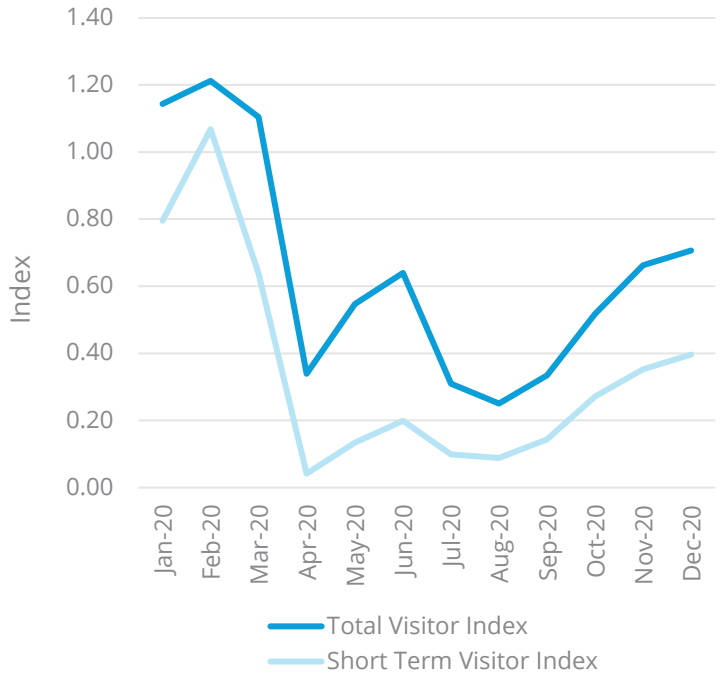


Source: Colliers Australian Hotel Investor Sentiment Survey

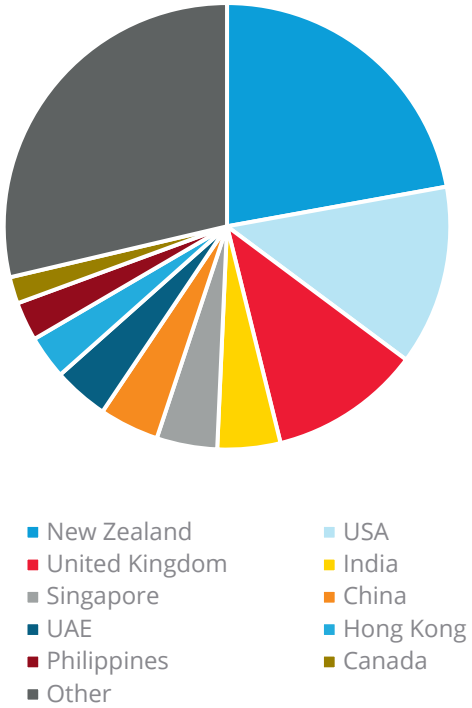
A snapshot of post-COVID travel to Australia

Profile of Short-Term Visitor Arrivals April to December 2020

Visitor Index – Arrivals v Departures – Index above 1.0 indicates more arrivals than departures



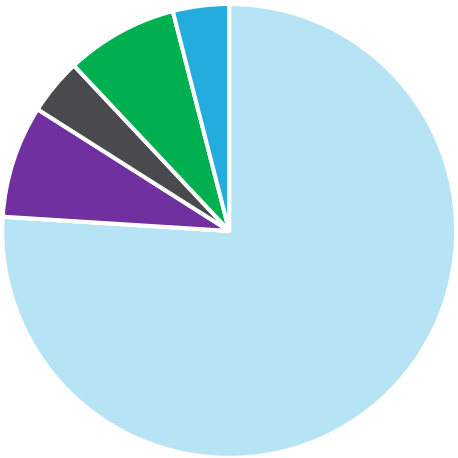
Visitor Arrivals to Australia April 2020 to December 2020



Source: Australian Bureau of Statistics Overseas Arrivals and Departures

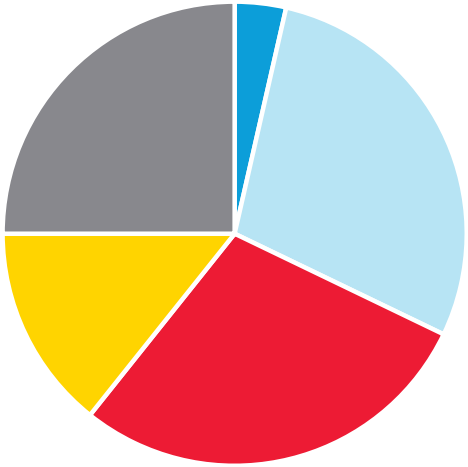
About the Respondents

Location of Company Headquarters



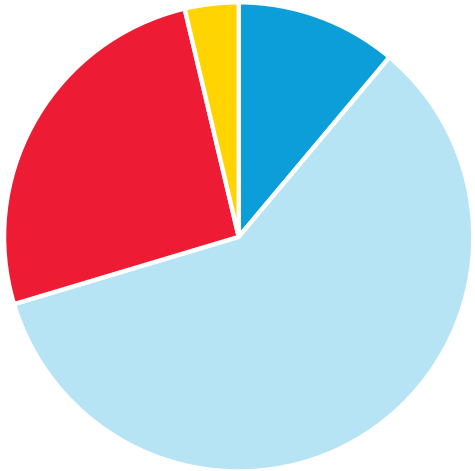
- Australia
- New Zealand
- North Asia
- South East Asia
- Other

Investor Type



- Bank / Institutional Investor
- Developer / Property Company
- Hotel Operator
- Investment Fund / Private Equity
- REIT
- Sovereign Wealth Fund
- Other

Investment Horizon



- Short Term (0 to 4 years)
- Intermediate Term (5 to 9 years)
- Long Term (10-20 years)
- Extended (20 years plus)

Source: Colliers Australian Hotel Investor Sentiment Survey

Methodology

This survey represents a compilation of more than 3,000 data points from hotel investors on future hotel operating performance expectations across Australia, yield requirements and future cap rate trends.

Additional responses are sought with each edition of the survey on a varying range of special interest topics.

The survey represents investors' expectations for trading performance for certain defined periods (namely H1 and H2 2021 and 2022) with results presented in line with the weight of opinion.

Net balance is the percentage of respondents who respond positively minus the percentage of respondents who respond negatively. The maximum score of + or – 100% indicates that all respondents have given a positive or negative response respectively. A score of 0% indicates the same number of positive and negative responses to a particular question.

The Australian average is the weighted average for all segments, based on the number of responses for each.

The survey represents the investment yield (cap rate) level required to consummate a transaction for a stabilised upscale asset, excluding repositioning through capital expenditure or new management focus. These yields are those that investors seek, while yields required to successfully secure an investment may vary. These yields should not be applied in any valuation or appraisal assignment.

Results for each city are calculated using the weighted average and are not framed with regard to specific timeframes, asset classes or investment rationale. Results are averaged across all respondents for the Australian average, based on the number of responses for each city.

Our Experts

A commitment to accountable service, delivered with integrity, honesty and transparency at all times is fundamental to our goal of creating long-term value through the development and provision of innovative and market-focused solutions.

Our strong corporate culture is reflected in our hotels teams approach to business.

For more information on how our team can assist you, contact one of our experts today.

AUTHOR

Karen Wales

National Director
Hotels Asia Pacific

M: +61 405 227 152
E: karen.wales@colliers.com

AUTHOR

Gus Moors

Head of Hotels | Australia

M: +61 404 005 066
E: gus.moors@colliers.com

Nigel Greenaway

National Director
Hotels

M: +61 431 288 677
E: nigel.greenaway@colliers.com

Guy Wells

Director
Hotels & Student Accommodation

M: +61 405 612 416
E: guy.wells@colliers.com

Mina Li

Associate Director
Hotels

M: +61 411 181 468
E: mina.li@colliers.com

Denise Kirk

Analyst
Hotels

M: +61 414 708 112
E: denise.kirk@colliers.com

Christopher Milou

Head of Hotels | Valuations
Hotels & Student Accommodation

M: +61 413 615 398
E: christopher.milou@colliers.com

Michael Thomson

National Director
Valuations, Hotels

M: +61 412 053 598
E: michael.thomson@colliers.com

Baden Mulcahy

National Director
Valuations, Hotels

M: +61 439 034 033
E: baden.mulcahy@colliers.com

Paul Ellis

Associate Director
Valuations, Hotels

M: +61 484 900 212
E: paul.ellis@colliers.com

Robert Bird

Valuer
Valuations, Hotels

M: +61 419 124 533
E: robert.bird@colliers.com

Emily Racki

AssistantValuer
Valuations, Hotels

M: +61 439 446 417
E: emily.racki@colliers.com

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