Briefing
Hotel sales & investment

May 2018

Image: Seoul, South Korea

SUMMARY

Asia-Pacific hotel transaction activity got off to a solid start in the first quarter of 2018, with most of the major markets seeing robust activity levels.

- Total Asia-Pacific hotel investment volume in Q1/2018 was US$1.98 billion, with transaction activity dispersed across most of the major markets in the region including China, Japan, Singapore, Thailand, Australia and South Korea. Hong Kong saw a notable drop in transactions during the quarter after a very busy 2017.

- China registered the highest transaction volume in the region, worth US$364.9 million and accounting for 18.4% of total volume. Notable transactions included the TPG and China Lodging Group's joint-venture (JV) purchases of an Ibis hotel and a Novotel hotel in Beijing from Ascendas Hospitality Trust, and Ascott Residence Trust's disposal of two Citadines-branded serviced residences.

- Japan was the second most active market with US$292.4 million worth of transactions, representing 14.7% of investment volume in the region. Among the notable transactions was Red Planet Hotels' sale and leaseback transaction with Goldman Sachs of three operating hotels and a development project.

"Despite ongoing political and economic challenges, the key Asia-Pacific hotel markets are seeing encouraging levels of investment activity. Strong cross-border investor appetite suggests that prime hotels which come to market will continue to attract aggressive bidding."
Savills Research

Market overview

Total Asia-Pacific hotel investment volume in Q1/2018 was US$1.98 billion, across 47 tracked transactions. Transaction activity was dispersed across most of the major markets in the region including China, Japan, Singapore, Thailand, Australia and South Korea. Hong Kong saw a notable drop in transactions during the quarter after a very busy 2017.

Transaction activity remains robust, with total transactions on a trailing 12-month basis up 15.5% compared to the same period last year. However, as the transaction market was particularly active in Q1/2017, this quarter is down 21.1% quarter-on-quarter (QoQ).

Northern Asia[1]

The Japan hospitality sector remains attractive to investors due to a tempting combination of strong arrivals growth, stable performance and attractive yields. Overseas visitor arrivals to Japan in 2017 reached 28.7 million, a 19.3% increase over 2016 while total spending by overseas tourists was up 17.8% during the same period. The surge in visitor arrivals in recent years has been putting significant strain on the country's tourist infrastructure with major airports facing capacity constraints.

The robust demand can be seen in incremental improvements in occupancy, particularly in Tokyo, Osaka and Kyoto. Although ADR has been stable, with hoteliers hesitant to increase rates, occupancy increased by 1.2 percentage points (ppt) to 87.4% in 2H/2017 versus the same period in 2016. This has led to a modest increase in the tracked RevPAR index of sampled limited-service hotels in Japan.

There are, however, some lingering concerns for hoteliers which is why they continue to shy away from firming rates. These include the unprecedented amount of new supply that is due to enter the market this year and beyond and the emergence of peer-to-peer accommodation, which is in the cross hairs of new regulations that are hoped to mitigate the impact of heightened competition. Furthermore, recent increases in labour costs and labour shortages that are expected to become more acute going forward all pose headwinds on profitability.

Somewhat paradoxically, the wave of new supply is also an endorsement of investors' confidence in the hotel sector. With very limited acquisition opportunities for operating hotels, investors have increasingly turned to hotel development, even groups for whom hotels were previously off the radar. Despite the sector-specific risks, hotels are in favour in Japan due to their attractive yields relative to office yields.

Although buyer interest remains strong, buyers have become more discerning in terms of asset quality and location. Furthermore, whereas J-REITS were previously the most aggressive in the market, foreign investors are becoming bolder with their bidding. It seems J-REITS are finding it hard to stomach sub 4% yields in some cases, whereas foreign investors may be prepared to go low to get a position in the market.

According to the Japan Real Estate Institute (JREI), expected cap rates on economy hotels in prime Tokyo locations compressed by an additional 0.2 of a ppt to 4.5%, since April 2017, confirming a strengthening acquisition appetite. The interest in the sector is likely to continue to compress cap rates, especially for hotels with fixed leases.

After the hiatus in activity in 2017 (which was due more to limited opportunities than lack of interest), Japan is expected to be among the most active markets in 2018, with attractive fundamentals fuelling interest from both local and foreign investors. The quarter saw 13 transactions worth US$292.4 million, representing 14.7% of investment activity in the region.

Among the notable transactions was Red Planet Hotels' sale and leaseback transaction with Goldman Sachs of three operating hotels and a development project worth US$111 million. Red Planet will continue to operate the properties in Asakusa, Naha, and Nagoya for a term of 20 years. This follows a 2016 investment by Goldman Sachs in Red Planet Hotels to help fund the hotel group's expansion.

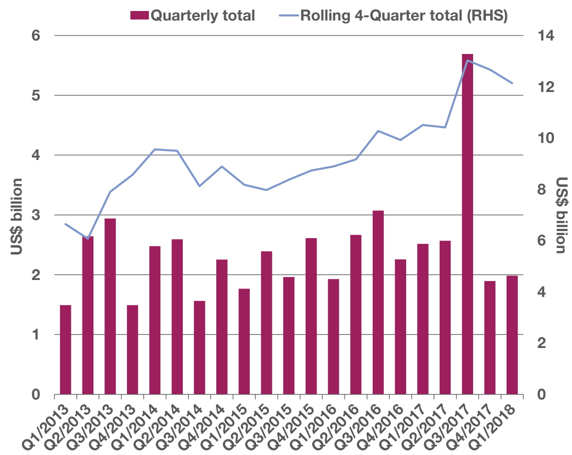
The Korean hotel market is still reeling from the impact of the political backlash from China, its biggest inbound source market. While international tourism arrivals are down significantly, supply has increased considerably in the last few years. As a result, many of the hotels are suffering in terms of performance due to the hit in occupancy.

A unique feature of the Korean hotel market is that many of the existing hotels are managed under a long-term master lease structure featuring minimum guarantees by the operators. Therefore, in this subpar performance environment where these minimum guarantees are being triggered, it is the hotel operator who is particularly exposed, not just the owner (though

1 Japan, South Korea

GRAPH 1

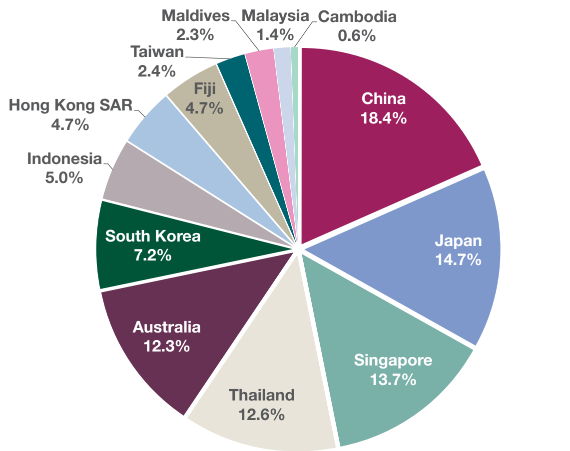
Investment sales transaction values, Q1/2013–Q1/2018



Source: Savills Research & Consultancy, RCA

GRAPH 2

Investment sales transaction volumes by location, Q1/2018



Source: Savills Research & Consultancy, RCA in many cases investors are owner operators). It is no surprise then that, although operator master leases still exist for new and particularly attractive projects, minimal guarantees are seldom offered, and increasingly, the market is accepting HMA structures, despite owners' general disdain for management agreements.

The long-term nature of the leases and the increasing rarity of minimum guarantees explains why investors aggressively bid for such assets. Resultant yields can be as low as 4.5% in some cases, despite the sluggish market performance.

The hotel sector is offering the longest leases in the market compared with other sectors; in some cases deals have 20 years still remaining to run. This makes them particularly interesting to domestic investors, and increasingly foreign parties are taking notice. As the existing funds move towards the tail end of their fixed terms, more hotel assets are expected to come to market.

Greater China

China registered the highest transaction volume in the region: US$364.9 million, which accounted for 18.4% of total volume. A JV between TPG and China Lodging Group purchased the Ibis Beijing Sanyuan with 397 rooms and the Novotel Beijing Sanyuan with 306 rooms from Ascendas Hospitality Trust for US$186 million total. The hotels are on adjacent plots in Beijing's Central Business District. The new owners plan to renovate the hotels, leaving the operator in place. The transaction marked TPG's first foray into China's commercial property investment market. Another notable transaction that was finalised during the quarter was Ascott Residence Trust's disposal of two Citadines-branded serviced residences in Shanghai and Xi'an for RMB980 million total.

Transaction activity suggests a growing trend of domestic transfers of assets from highly leveraged investors, who are in some cases under the regulator's spotlight, to other local groups with strong balance sheets but who are not under the microscope. It is evident that Chinese capital is still chasing hotel assets, not only within China but also overseas. Despite the strategy being officially discouraged, certain Chinese groups remain active in sourcing hotel assets in the major regional markets such as Australia.

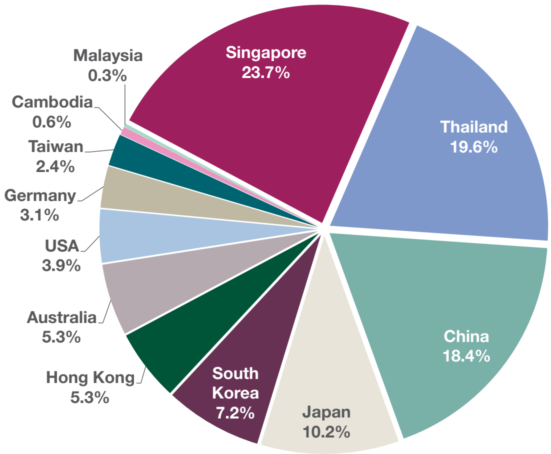
Southeast Asia and South Asia

Within the Southeast Asia region, Singapore and Thailand were the standouts this quarter. In Singapore, Perennial Real Estate Holdings acquired from an affiliate of Pontiac Land its 50% stake in Capitol Singapore for S$528 million. The two parties, previously JV partners in the development, were embroiled in a protracted disagreement going back to 2016, which resulted in the hotel and part of the retail podium remaining closed. The hotel component was previously planned to be branded as The Patina Hotel, to be managed by Pontiac Land's Patina Hotels and Resorts.

In Thailand, Singha Estate has been particularly active recently. The group, having announced a large scale nine-island resort project in the Maldives last year, acquired a portfolio this quarter from Outrigger of six assets across Thailand, Mauritius, Maldives and Fiji worth a total of US$250 million. The group announced plans to issue units in a REIT worth up to 20 billion Baht by 2020.

GRAPH 3

Investment sales transaction volumes by buyer origin, Q1/2018



Source: Savills Research & Consultancy, RCA

Australia and New Zealand

Transaction volume in Australia amounted to US$244.4 million in the first quarter of the year, with Singaporean groups active in terms of both acquisitions and disposals. Commerz Real (Germany) purchased the 194-room Mercure Brisbane and the 218-room Ibis Brisbane hotels from Singaporean hospitality trust CDL for A$77 million, with a reported yield of 5.3%. Melbourne-based SB&G Hotel Group purchased two hotels in Queensland for A$100 million from Japan-based HIS International. These were the 388-room Watermark Hotel & Spa Gold Coast and the 94-room Watermark Hotel Brisbane. In another transaction, Chip Eng Seng (Singapore)

TABLE 1

Selected investment transactions, Q1/2018

Hotel	Location	Approximate sale price (US$ mil)	Approximate price per room (US$)	Buyer
Ibis Beijing Sanyuan & Novotel Beijing Sanyuan	Beijing	186	265,000	JV between TPG and China Lodging Group
Ibis Brisbane & Mercure Brisbane	Brisbane	61	149,000	Commerz Real
Outrigger Portfolio	Various	250	291,000	Singha Estate

Source: Savills Research & Consultancy
Note: AU$/US$ = 1.2814

purchased the 245-guestroom Mercure & Ibis Styles Grosvenor Hotel in Adelaide from Accor Hotels Group for A$43 million.

Although the transaction market is still relatively quiet in Australia, foreign investors are scouring the market for hotel opportunities, with China, Hong Kong, Japan and Singapore being the main sources of capital. Many owners seem to be opting to hold their assets for fear of being cashed up without the ability to re-enter the market. This resulting dearth of opportunities is driving up prices and causing yields to continue to tighten, although evidence of yield compression is showing signs of slowing.

Despite the lacklustre start to the year, the outlook for 2018 is generally positive with hotel enquiries remaining strong and owners considering options. It is anticipated that 2018 will see increased transaction activity, particularly in Sydney and Melbourne, as developers may look to exit their hotels to take advantage of robust capital values, the lack of availability of existing investment grade hotels, and to capture the ubiquitous and deep pools of capital still searching for hotels in these key markets.

Counter-cyclical opportunities may be presenting themselves in 2018 in Brisbane and Perth. The hotel market in Brisbane seems to have bottomed out, but will benefit from the Commonwealth Games on the Gold Coast and significant public infrastructure projects. On the other hand, Perth has additional new supply still to enter an already soft market, which in the short term will lead to continued downward pressure on performance. However, the market may present buying opportunities for well capitalised counter-cyclical investors.

OUTLOOK

The prospects for the market

- After a strong performance in 2017 (US$12.5 billion), the transaction pace in 2018 is expected to slow to US$9.0 billion due to the lack of investment opportunities.
- Prime assets will continue to be the most sought-after products on the market with a particular focus on prime properties located in Tokyo, Hong Kong, Sydney and Singapore and dominant resorts in Phuket and Bali.
- Asian investors will also continue to look for opportunistic acquisitions of properties in Europe and North America where returns are higher than in Asia.

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