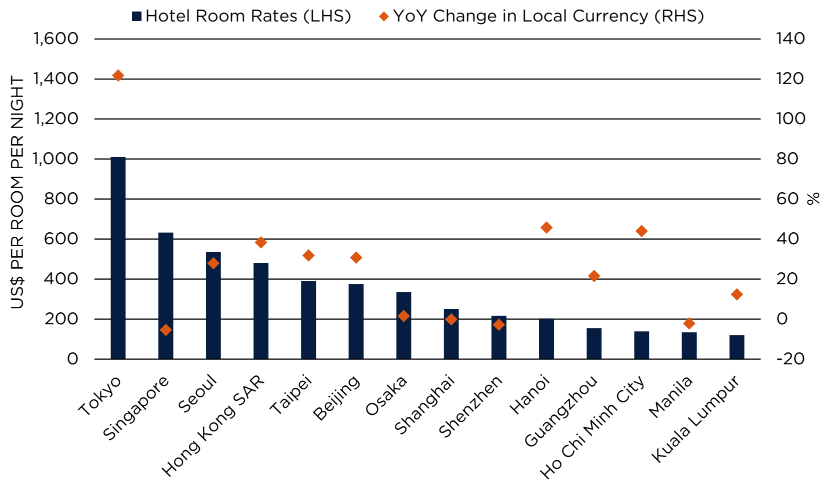
Asia Pacific - November 2023

SPOTLIGHT
Savills Research

Asia Pacific Hospitality

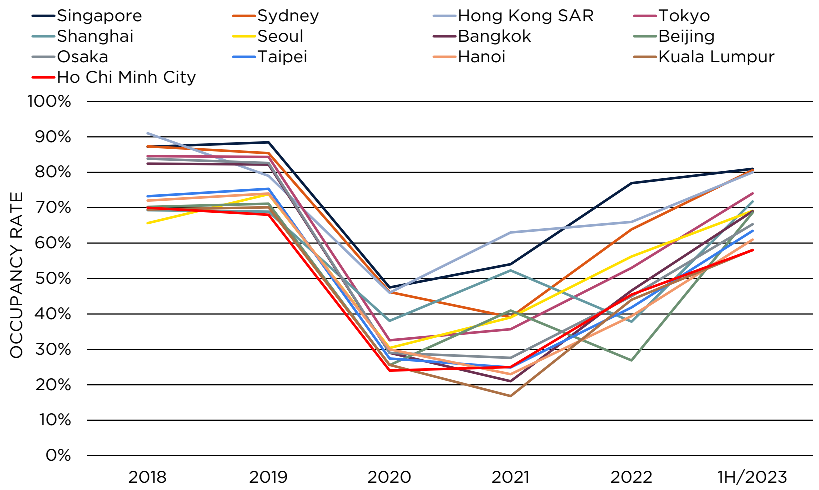
Reviving demand and inflation-proof revenues rekindle interest in hotel investment

GRAPH 1: Prime Hotel Room Rates by Market, 1H/2023



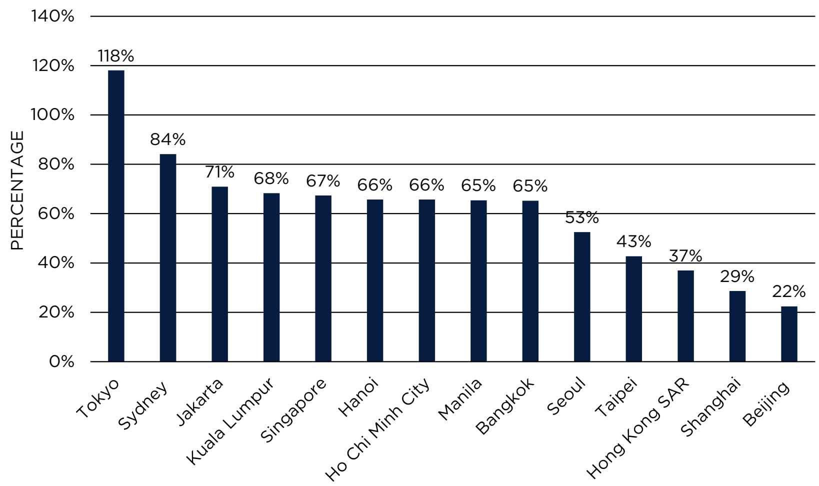
Source Savills Research & Consultancy,
Note Prime hotel basket is made up by a small number of prime buildings (5 to 10) in each market.

GRAPH 2: Hotel Occupancy Rates by Market, 2018 to 1H/2023



Source Market sources, Savills Research & Consultancy, STR

GRAPH 3: International Visitor Arrivals by Market, 1H/2023 vs 1H/2019



Source Government statistics, Savills Research & Consultancy

PENT-UP DEMAND BOOSTED HOTEL RATES IN EARLY 2023, THOUGH OCCUPANCY ROSE MORE SLOWLY

After a strong rebound in late 2022 amid the staggered reopening of some major regional economies, the Asia Pacific hotel market has finally emerged from its hibernation. The release of pent-up demand during the early part of 2023 boosted hotel room rates significantly, and ten of the 14 prime hotel markets in the region recorded growth during the first six months of the year. Local room rates rose above pre-pandemic peaks in many markets, with Tokyo leading the expansion with a bumper 122% YoY rise while others including Seoul, Hong Kong SAR, Taipei, Beijing, Ho Chi Minh City, and Hanoi also witnessed room rate hikes of 20% to 40% YoY.

While room rate rises were driven by the influx of international tourists and their ‘revenge spending’, they also reflected a lack of capacity in many areas including staff shortages, limited flights, rising fuel prices and operational costs as post-pandemic inflation took hold. As such, the recovery in occupancy has been much slower than expected, with most markets in a range of 60% to 80% in 1H/2023 compared with the 70% to 90% levels recorded pre-pandemic. It should be remembered that major economies in the region were some of the latest worldwide to relax border controls.

In terms of volume, international tourist arrivals are projected to reach 56% of 2019 levels in 2023 and 84% by 2024 for the Asia Pacific region according to Oxford Economics. Mainland Chinese travellers, who used to be the largest source market for the region, have been slow to return due to visa restrictions, limited airlift capacity, and increasing travel costs. The passports of about 20% of Chinese travellers expired during the COVID-19 period based on Mckinsey estimates and while renewals are now possible, the backlog and the subsequent wait times has further delayed any recovery.

Meanwhile, the passenger capacity for international air routes only recovered to about 23% of 2019-levels in 1H/2023 across mainland China, resulting in a rise of 20% to 30% on average in prices for outbound group tour products on major online booking platforms, prompting more cost-conscious travellers to stay at home instead. As such, we have seen the strongest rebounds in destinations with a diverse source market profile less dependent on Chinese visitors.

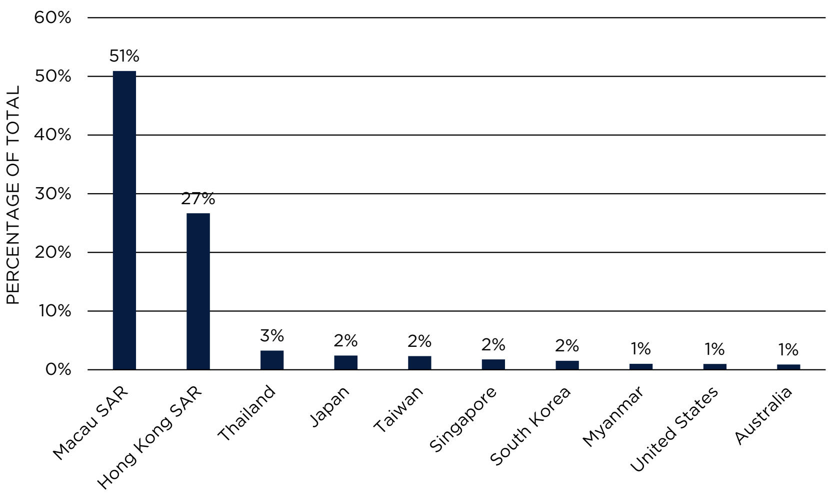
In 1H/2023, Tokyo tallied the strongest arrivals with a 118% rebound in international arrivals compared to pre-pandemic levels, followed by Sydney at 84%, while most other major destinations ranged from 60% to 70%.

Looking across the region, Hong Kong SAR has historically relied most on mainland Chinese arrivals who accounted for 78% of the city's inbound travellers in 2019, and the city is therefore one of the worst performing markets currently. Recovery has been muted in other markets like Seoul and Taipei, where 30% of arrivals used to come from mainland China.

According to a report released by the China Tourism Academy, Macau SAR and Hong Kong SAR remained the most popular destinations in 1H/2023, receiving about 51% and 27% of outbound mainland Chinese tourists. Neighbouring countries like Thailand (3%), Japan (2%), Singapore (2%), South Korea (2%) and Myanmar (1%) are also popular, but not to the same degree.

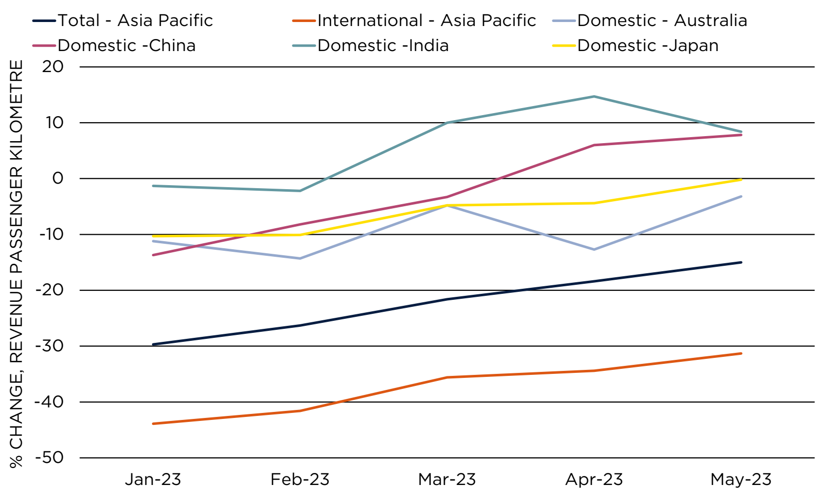
Though investment activity declined across much of Asia Pacific in 2023, some bright spots did emerge as Japan saw increased volumes and foreign capital targeted inflation hedging assets in rebounding markets with diverse demand sources.

GRAPH 4: Mainland Chinese Outbound Tourist Volume by Market, 1H/2023



Source China Tourism Academy, Savills Research & Consultancy

GRAPH 5: Passenger Traffic Against 2019-levels by Air Route, January 2023 to May 2023



Source IATA, Savills Research & Consultancy

Not surprisingly, many markets in the region are actively trying to encourage the return of this major travelling group. Thailand was one of the first to be approved for group tours by the Chinese government, and it has also introduced a visa waiver scheme for mainland Chinese travellers running from September 25th until February 2024, covering the major holiday seasons. The Thai government says that this will drive 2.88 million Chinese visitors during the five-month period, slightly higher than the 2.34 million Chinese visitors who visited in the first eight months of 2023.

The recent addition of Australia, Japan, and South Korea to the approved list, should bolster demand in those respective destinations, although any impact is weighted toward the longer-term. South Korea has waived visa processing fees for Chinese tourists through to the end of December and increased flights between the two countries. Taiwan has resumed short-term business travel visas and issuance of travel permits to mainland Chinese tourists who have lived outside mainland China since September, though tourism activity between these two regions is expected to remain sluggish amid geopolitical concerns.

DOMESTIC TRAVEL FUELS THE REVIVAL AMID SLUGGISH INTERNATIONAL FLOWS

Domestic tourism served as a lifeline for hotels during the pandemic, with people turning to local destinations for short breaks and domestic demand remains the driving force behind sector recovery in some markets.

Currency weakness across the region against the US dollar has meant that more people are looking at short-haul trips at home, especially price-conscious travellers. For example, in Japan, the weak Yen combined with the lifting of social restrictions has been driving the revenue and room rates of limited-service hotels and ryokans across various domestic travel hotspots.

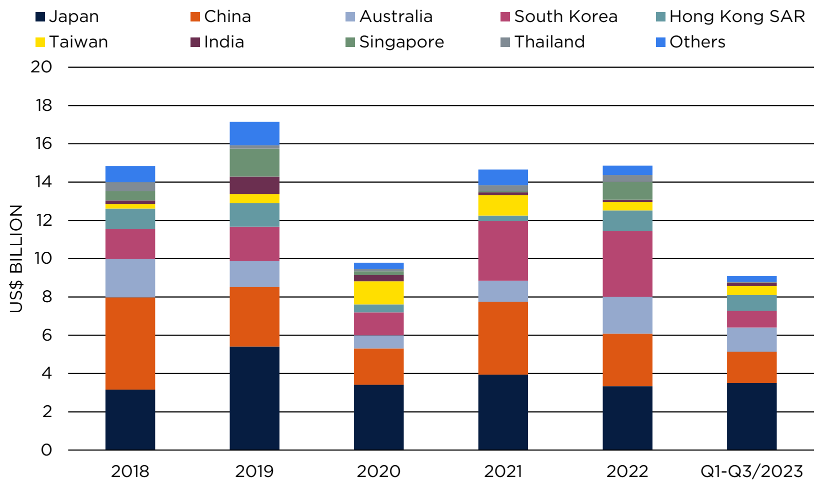
On the other hand, China, and India both have enormous domestic markets, receiving over 6.0 billion and 2.3 billion domestic visitors respectively in 2019 prior to the pandemic, making them easily the two largest domestic tourism markets in the region. According to data from the International Air Transport Association, monthly domestic air passenger traffic volumes in India exceeded pre-pandemic levels from March 2023 onwards, with China following suit in April 2023. This strong domestic demand is helping to make up for some of the shortfalls in international flows, especially in less inbound-dependent locales.

STRUCTURAL CHANGES HURT BUSINESS TRAVEL

Much of the surge in Asia Pacific hotel activity has been driven by leisure travel, while high-spending business travellers are largely missing from the picture, with corporate travel recovering to less than 30% of pre-pandemic levels so far in 2023. Even regional hubs like Singapore are only expecting a full MICE recovery between 2024 and 2025. There are concerns that the shift in demand is not just cyclical but structural, as business travel faces challenges around corporate travel budget cuts and companies allowing more flexibility for remote work and virtual meetings.

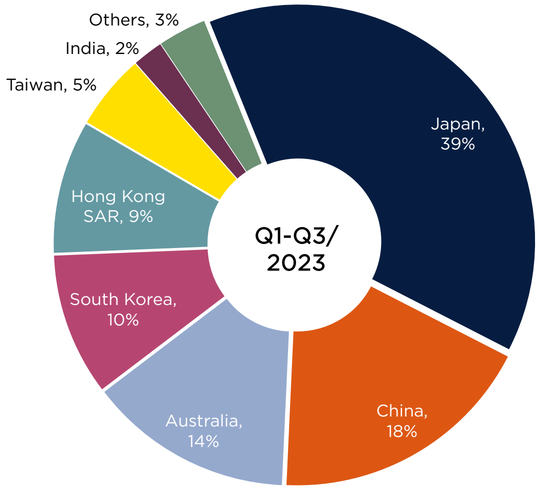
For full-service hotels which rely on high-spending business demand, room rates have recovered close to pre-pandemic levels, but revenue streams from banquets, conventions and other sources remain constrained. As such, limited-service hotels oriented towards leisure segments have seen a relatively faster rebound in occupancy rates and RevPAR so far during the recovery.

GRAPH 6: Asia Pacific Hotel Investment Volume by Market, 2018 to Q1-Q3/2023



Source MSCI Real Capital Analytics, Savills Research & Consultancy
Note Investment volume includes property transactions for hotel use with a deal size of US$10 million or above.

GRAPH 7: Share of Asia Pacific Hotel Investment Volume by Market, Q1/2023 to Q3/2023



Source MSCI Real Capital Analytics, Savills Research & Consultancy
Note Investment volume includes property transactions for hotel use with a deal size of US$10 million or above.

MULTI-SPEED INVESTMENT MOMENTUM AMID MACROECONOMIC UNCERTAINTY

Throughout the pandemic, hotel assets were hit hardest and have already undergone a more significant price adjustment than other sectors. As inflation rates in many Asia Pacific markets stand at decade-highs, this sector has garnered increased interest from investors seeking an inflation hedge, however. The ability of a hotel to adjust rates daily is certainly more appealing compared to properties tethered to long-term fixed incomes. Deal flows in the region remain constrained however, given global financial conditions.

In the first three quarters of 2023, the overall volume of hotel transactions valued at US$10 million or above in the region declined by 28% YoY, whereas the deal count dropped by 17% YoY. However, on a submarket level, a more mixed picture emerges. While investment volumes dropped substantially in many major markets including Singapore, Thailand, and South Korea, and moderately in Hong Kong SAR, China and Australia reflecting the downside pull of rate hikes, a number of markets including Taiwan (24% YoY), Japan (27% YoY) and India (150% YoY) have seen activity tick higher.

Of the US$9.1 billion funds flow during the first nine months, over a third (39%) of this capital was deployed in Japan. A low interest rate, a weak currency, and a strong rebound in demand combined with consistent GDP growth have all helped the country's reputation as a safe haven during times of uncertainty. Hotel transaction volumes in the first three quarters of 2023 have already surpassed the same period in 2022 by 27% YoY, and these figures are preliminary and likely to increase. International investors appear especially keen, with overseas capital comprising around 61% of the total transacted volume.

We have also observed a consistent trend for foreign funds to acquire non-core assets from corporate owners as they restructure their portfolios to raise capital. For example, a joint venture comprising SC Capital, the Abu Dhabi Investment Authority, and Goldman Sachs Asset Management procured a portfolio of 27 resort hotels from Daiwa House. This portfolio, comprising over 7,000 rooms, was acquired for US$900 million, marking the most substantial hotel transaction of 2023. Meanwhile, an SPC invested by KKR and Gaw

Capital completed the acquisition of the Odakyu Century Building in Tokyo in June, which houses the Hyatt Regency Tokyo (746 units), for US$409.3 million from Odakyu Electric Railway.

Another active foreign investor in the Japan market is the Canadian private equity firm BentallGreenOak (BGO), who has purchased seven hotel properties this year alone, including a five-hotel portfolio in Kyoto under a JV between its subsidiary BGO SPC and Pegasus Capital in February, the Rihga Royal Hotel (1,039 units) in Osaka for US$403.3 million in March, and the newly opened 167-room Ritz Carlton Fukuoka in June. For the landmark Righa Royal Hotel, the buyer is partnering with IHG Hotels & Resorts to relaunch the property as Japan's first Vignette Collection hotel after refurbishment as part of a value-add strategy.

Moreover, there is also a keen interest in landmark property in key gateway cities. For example, South Korean real estate firm Bluecove Investment acquired the Grand Hyatt hotel in Seoul for US$522 million in May. Meanwhile, the Waldorf Astoria Hotel (220 units) in Sydney was sold for US$406.4 million representing a unit price of US$1,847,382 per key. These assets can command high room rates and can fully capitalize on any tourism surge, making them attractive income-generating vehicles.

On the other side, price reductions and distressed sales have been behind the momentum in some markets, particularly China, with domestic investors the main players in this field. For example, in Q3 alone, we saw a number of auction sales ordered by banks including the US$226 million sale of Sheraton Shanghai Hongkou (471 units), the US$68 million sale of the Phoenix Mountain Tourism Resort in Guangzhou while a pair of hotels, namely the 523-key Crowne Plaza and the 489-key Best Western Premier in Hefei, were auctioned for a third time and sold for US$93 million.

Meanwhile, in India, the Renaissance Marriott High Grounds Hotel (278 units) in Bengaluru (Bangalore) was sold by a bank for US$36.5 million. The end of the Emergency Credit Line Guarantee Scheme (ECLGS) may prompt more distressed assets to surface from insolvent businesses over the coming months.

POSITIVE OUTLOOK AHEAD BUT RISKS TEMPER INVESTOR ENTHUSIASM

Overall, the Asia Pacific hotel sector is in the healthiest state it has been in since the onset of the pandemic, exhibiting promising signs of recovery. More hotel transactions are likely to occur going forward as investors perceive further growth potential on the horizon. Pent-up travel demand, easing restrictions, and reopening momentum has improved buyer appetite, especially for those seeking a hedge against inflation. We believe that the investment spotlight will remain on Japan for the coming year, while upscale and luxury hotels in key destination cities are expected to see greater interest from income-focused or core-strategy investors.

Markets with robust growth potential, such as domestic hotspots in China and India, as well as destinations in Southeast Asia with a strong international pull, can also expect to attract attention from regional investors, though opportunities are capped by the limited availability of quality projects.

Despite the positive market cycle, strong market fundamentals, and flexible rental income, investors are still cautious given the 'higher for longer' rate environment. Ongoing labour shortages in certain mature markets could also limit the sector's ability to cater to rebounding tourism demand. Geopolitical tensions and economic instability, especially surrounding China, also pose downside risks which may hold back performance, hampering the speed and scale of any tourism recovery.

Short-term turbulence aside, for those with a medium to long-term outlook, hotels remain an attractive asset class in Asia Pacific. The industry is well supported by a myriad of favourable drivers, including a growing middle-class population with rising disposable incomes, more leisure time and increasing demand for more experience-driven tourism to the benefit of hotel stays.

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