

2008 HOTEL INDUSTRY SURVEY OF INVESTORS & LENDERS “The Hotel Investor Dilemma”

Investor / Lender Sentiment

HTL Capital Advisors 2008 survey of key investors and lenders in the Australian hotel industry was undertaken over the past two months. Investors surveyed collectively own several billion dollars of hotel investments, whilst hotel lenders were from leading banks. Survey findings, follow:

Outlook Issues	Investors	Lenders
Outlook Reasonably to Very Positive	75%	67%
Hotels More Attractive Than Other Real Estate	58%	0%
Worse Outlook for Equity – Existing	42%	-
Worse Outlook for Equity – New Build	50%	-
Worse Outlook for Debt – Existing	-	33%
Worse Outlook for Debt – New Build	-	35%

These findings highlight a dilemma for investors in mid-2008. On the one hand, hotel revenues in most markets remain at historically high levels suggesting a continuation of strong investment returns from the sector. But on the other hand the current debt crisis and economic pressures threaten demand and investment performance over the longer term.

The table above also reveals that investor optimism about the comparative standing of the industry is not shared by lenders - no lender in the survey rated hotels better lending propositions than other real estate types, whilst two thirds of lenders considered hotels to have the same appeal as other classes of real estate for lending purposes.

The expected longevity of the current debt crisis was a further point of investor/lender divergence in their responses. 50% of investors expect the debt crisis to last 12-18 months, whereas 67% of lenders expect it to last 18-24 months.

Of further concern, over one third of lenders in the survey expect a “large increase” in problem loans and insolvencies for hotel related loans in the year ahead. Given the strength of current operating conditions, this implies the possibility of looming borrower difficulties from corporate debt positions rather than hotel specific loans - a scenario that was last seen during the debt crisis in the 1990s.

Comparative State of Markets

Further reflecting the generally optimistic sentiment of investors, the survey respondents declared 2008 to be the second best year in the past decade for hotel operating performance and the third best year in the past decade for hotel investment returns.

Investment Threats

Respondents were asked to rank 20 specified potential threats. The highest ranked threats were as follows:

Main Threats & Ratings	Investors	Lenders
Shortage of Debt	1	-
Shortage of Equity	-	=2
Prices Too High	-	1
Economic Concerns Locally	2	-
Economic Concerns Overseas	=3	=3
Interest Rate Concerns	=3	=2

Investor and lender concerns in part reflect their anxieties about threats that they have less direct knowledge of. For example, lenders are concerned about a shortage of equity, whereas investors are more concerned about a shortage of debt. However both groups share a mutual concern about economic and monetary threats.

Location Preferences

Investors declared their preferences from 20 hotel markets in the region in 2008, as follows:

Rank	Existing	Development
Most Desired Markets:		
1	Sydney	Brisbane
2	Brisbane	Sydney
3	Perth	Perth
4	Melbourne	Melbourne
5	Wellington	Wellington
Least Desired Markets:		
1	Cairns/FNQ	Cairns
2	Whitsundays	Gold Coast
3	Gold Coast	Queenstown

Investors rated Perth the best “value for money” location.

Preferred Types of Hotels

Investors ranked 8 types of hotels as follows, according to achieved return on investment (highest returns first):

Hotel Category	Investors	Lenders
Mid Market	1	2
1 st Class	2	3
Budget	3	5
Serviced Apartments	4	1
Luxury	5	7
Boutique	6	6
Backpackers	7	4
Resorts	8	8

The strong level of investor and lender support for mid market and first-class hotels reflects the improved level of returns and values of these property classes over recent years. It may also reflect a perceived safety for those sectors in the event of any slippage in room rates as a result of any softening of demand.

In contrast, luxury hotels and resorts are perceived by some lenders and investors as representing higher risk options. Resorts as an accommodation class have generally had a historically poor trading track record in Australia, whilst there are only a limited number of investors with the financial capability for the high entry cost into the luxury sector.

Serviced apartments are well regarded by lenders because the way they are financed limits lender exposure due to the need for developer pre-sales to the public.

Capitalisation Rates

Investors nominated capitalisation rates for 17 hotel markets as follows. For comparison the findings from Jones Lang LaSalle's Hotel Investor Sentiment Survey of December 2007 are also shown below:

No.	Location	HTL Capital Advisor 2008 Survey	JLL Hotels Survey Dec 07*
1	Sydney	7.3%	7.5%
2	Melbourne	7.5%	7.9%
3	Perth	7.6%	8.1%
4	Brisbane	7.7%	8.1%
5	Canberra	8.1%	-
6	Adelaide	8.1%	-
7	Auckland	8.3%	8.8%
8	Wellington	8.4%	-
9	Gold Coast	8.6%	8.4%
10	Queenstown	8.9%	-
11	Sunshine Coast	9.0%	-
12	Darwin	9.0%	-
13	Tasmania	9.1%	-
14	Christchurch	9.2%	-
15	Cairns/FNQ	9.5%	-
16	Tweed Coast	9.6%	-
17	Whitsundays	9.8%	-

* Ave rate for new acquisition

Interestingly, transaction evidence indicates that faced with a specific investment opportunity, investors are often prepared to pay more than they might suggest in surveys of this type.

To some extent in recent years this has been a reflection of bullish market conditions and a scarcity of acquisition opportunities that have created competitive tension and high sale prices. It will therefore be interesting to observe whether such an outcome will continue in the less buoyant investment conditions expected during the period ahead.

The capitalisation findings above provide interesting insight into the changing state of the individual hotel markets in Australia and New Zealand over recent years.

Of particular note is the re-rating of the Perth market in the last two to three years, consequent upon its belated but substantial surge in room rates and an increased investor appetite for that market created in the wake of a mining led economic revival.

Also of interest is the narrowing of value between the three major east coast cities as both Brisbane and Melbourne continue to grow in strength in investor perception terms and to a level that now ranks them closely behind Sydney.

Whilst Canberra and Adelaide have traditionally been the "poor cousins" in hotel investment terms with few supporters, improving trading performance and stronger local economies are now finally working in favour of both cities.

Despite difficult trading conditions in some parts of New Zealand, improved investor perceptions about Wellington in particular and to a lesser extent Auckland and Queenstown provide positive indicators.

Investor Strategy

2008 Is A Year To....	Investors
Hold Existing Hotels	39%
Acquire Hotels	46%
Sell Hotels	15%

Investor reluctance to sell continues, thereby potentially frustrating the high level of acquisition demand for hotels also indicated above. Accordingly, an expectation of value buying opportunities by cashed up buyers in the wake of the debt crisis may not be realised in the short term.

The rationale for holding or acquiring hotels can also be seen in investor's assessment of where the Australian five-star hotel market is up to, by reference to the "investment cycle clock". Almost 50% of investors declared that the clock was presently between 10pm and midnight, whilst only 20% considered that it was past midnight.

Also consistent with the hold sentiment and the shift of purchaser type towards long term property holders, the average declared hold period for hotels is now 8.8 years.

Beyond Australia, investors declared the USA and China as the most desirable alternative hotel investment market.

Conclusion

The Survey reveals continuing investor (and to a lesser extent, lender) confidence about the industry outlook, but an increasing focus on industry and capital related risks. Investor confidence in the state of the industry partly explains a reluctance to sell hotel assets at this time and to selectively acquire additional assets as and when fair market value opportunities emerge.

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About HTL Capital Advisors
HTL Capital Advisors is a network of offices created by principals of Horwath HTL in various cities around the world to provide transaction and capital raising services to hotel industry participants. HTL Capital Advisors works in parallel with Horwath HTL offices to provide a comprehensive suite of services for clients locally, regionally and globally, under a brand without borders principle.