UNLOCKING HIDDEN POTENTIAL IN ANZ REAL ESTATE

- Ronald Stephen Barrott, **Pro-invest Group**

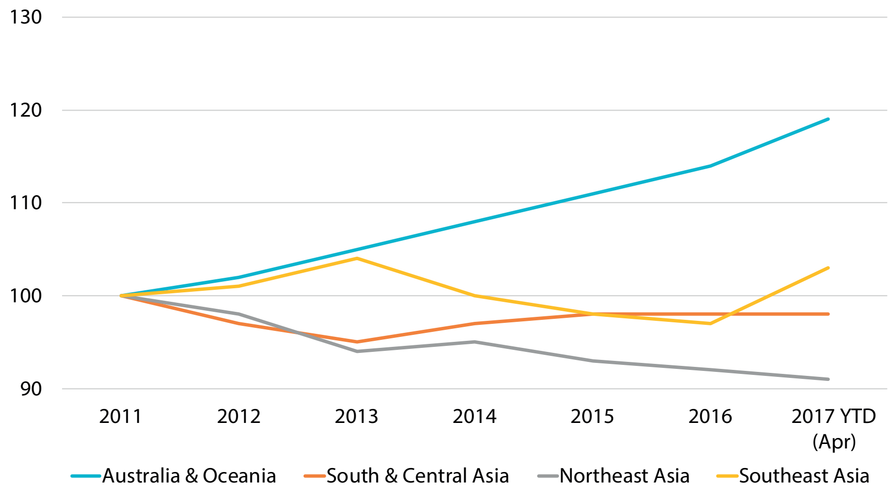
In recent years, hotels have become an established asset class trending in line with core sectors. Provided hotels are skilfully acquired and actively managed, hotel investments can generate attractive yields. Hotels within the Select Service segment in particular have proven to be an attractive investment, demonstrating double-digit, cash-on-cash returns to investors. In recent years, hotels have attracted stronger investor attention globally, with prominent US and Asian REITS becoming increasingly active in the sector.

HOTEL MARKET IN ANZ: DEMAND IS OUTSTRIPPING SUPPLY

The strength of the Australian and New Zealand hotel markets has been underpinned by robust demand growth over recent years which has resulted in a net demand-supply gap in both markets. This has led to strong occupancy, Average Daily Rate (ADR) and Revenue Per Available Room (RevPAR) growth. As a result, ANZ hotel markets are among the top performing in the APAC region, behind only Japan and Singapore on an occupancy basis.

The markets have shown resilience to economic downward pressure with RevPAR growth in ANZ growing consistently year-on-year since 2011. This is comparatively attractive as in the other Asian regions RevPAR growth was volatile or negative over the same period, as illustrated in Fig. 1. STR Global research indicates that Australia has experienced one of the most consistent hotel demand growth rates of all global markets, with 85 months of demand growth. Sydney and Melbourne are the strongest performing markets and continue to attract a growing number of international visitors and international hotel investment. Despite substantial supply pipelines outweighing demand in certain markets – namely Brisbane, Perth and Darwin – it is anticipated that demand will catch up with supply in the medium-long term.

Fig. 1: RevPAR Indexed to 2011, Local Currency



Source: STR 2017

Similarly, the New Zealand hotel market continues to experience record strength which can be attributed to robust growth of international arrivals, increasing 10% in the year ending May 2017. Auckland and Queenstown maintained their position as the top performing markets attracting strong RevPAR growth in the year ending March 2017 at 16.2% and 17.6% respectively. Colliers International notes that the lack in supply is limiting the sector's growth.

ANZ markets have historically lacked high-quality, consistent and competitively priced accommodation facilitates that corporate clients demand; and despite hotel supply growing strongly over recent years compared to historical levels, demand continues to outstrip supply. Indeed, hotel products that satisfy the corporate and millennial markets' expectations can help ensure occupancy exceeds its fair share against its competitors. Further, these hotel products will reduce the likelihood of guests using alternative accommodation such as Airbnb, as corporate travellers are not as willing to accept staying at somebody's home given the lack of service consistency and grey areas around insurance policies and potential tax avoidance (which corporates cannot expose themselves to).

WHY INVEST IN ANZ HOTELS NOW

MSCI analysis has indicated that Australian hotel assets offer a more attractive risk-adjusted return than the premium CBD core asset class – that is, office and retail assets. The income returns of Australian institutional-grade hotels have demonstrated low volatility over past years, with running yields around 7-8% per annum before leverage. Hotels that target a range of segments, including both corporate and leisure, and have efficient cost structures such as Select Service hotels, are significantly more resilient to market downturns.

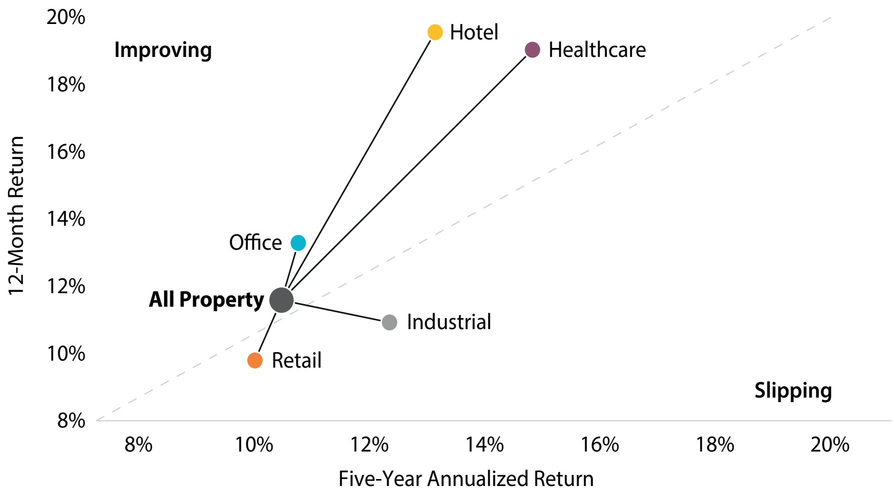
The relatively stable income returns and running cash-on-cash yields in the early teens are of particular interest to institutions such as pension funds, superannuation funds, insurance companies and, indeed, the majority of investors looking for a higher yield in our current low interest rate environment.

As the supply of Select Service accommodation falls significantly short of demand in Australia, there is presently the opportunity for investors to create a secure, growing income stream through the development of new, purpose-built, efficient hotel assets in areas where under-supply is particularly acute.

Pro-invest Group is in the position of having established an integrated hotel investment platform, including asset management, development and operational management. The Group is developing a portfolio in excess of A$1bn of Select Service hotels in major cities throughout Australia and New Zealand with a focus initially on a geographically diversified portfolio in CBD locations and hence following a "Build-to-Core" strategy. By developing new, efficient, A Grade buildings, Pro-invest ensures that assets meet the latest guest expectations, with a portfolio of modern, future-proof properties that are well positioned to generate long-term, stable cash flows. Furthermore, the Group's exclusive arrangements with hotel brands assist with deploying funds in a sensible manner over a short period of time, thereby providing the level of scalability institutional investors demand and satisfying the pressure to put funds to work.

The complexity of hotel assets/operations requires specific active management to maximize returns, with expertise in areas ranging from distribution, yield management, marketing and payroll to energy, maintenance and capital expenditure. While it is difficult to measure the impact an asset manager may have, research suggests that it may enhance departmental profits by 3-5% and 5-15% of Gross Operating Profit margins and hence every hotel asset is being managed by Pro-invest's in-house team holding decades of experience and track record in those areas.

Fig. 2: Hotels Outperforming Other Property Classes in Australia



Source: MSCI

In an environment where development finance remains constrained, investors that are willing and able to fund hotel developments can access attractive returns, compensating them for the associated development and letting risk. Our track record proves that we can mitigate most of these risks by a) acquiring sites that have undergone an assessment of the local environment, market and planning authority constraints and b) partnering with the largest international hotel management companies to leverage room nights from their corporate accounts and large reservation system, which drive high occupancy rates.

OUTLOOK

The low interest rate and inflationary environment is anticipated to continue encouraging institutional investment for hotel assets in the medium term. As a result, initial yields are forecast to continue compressing over the next 12 months.

When looking at the 'classical' geographies institutional investors like to 'tap into', there is a growing level of concern and uncertainty owing to Brexit, the EU's political disengagement, the US election and the fact that most Asian markets – despite their fundamentally strong economies – are perceived to be on the higher spectrum of country risk. However, Australia and New Zealand are appealing given their diversified economic fundamentals which have proven to be more resilient to soft market conditions than expected, for example the commodity bust.

To maximize risk-adjusted returns, investors should consider looking beyond traditional core strategies and standing office buildings in Sydney or Melbourne and team up with managers that can secure/develop the right assets in the right locations and implement an active management approach in which investor and fund manager interests are aligned.

Pro-invest follows a 'value-add' philosophy. Pro-invest caters to investors' individual risk and return preferences by offering several investment options, including funds with a tailored investment strategy, separate accounts that are customized to an individual's investment preferences and select joint venture arrangements. Considering the uncertainty in the global markets, now seems a good time to take advantage of the opportunities that exist in the ANZ real estate markets for attractive, long-term income returns.

PRO-INVEST GROUP
Pro-invest Group is a leading international private equity real estate firm specialised in investing into hospitality, retail and office assets with an active management approach. The Group has a long track record in developing as well as operating hotels in Europe, Middle East and Asia and is managing the Pro-invest Australian Hospitality Opportunity I, which owns, develops and operates a portfolio of select service hotels across Australia and New Zealand, and has a development portfolio of over A$1bn.

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