Hotels as the hidden jewel for your 'beds and sheds' strategy

Given the disruptive impact COVID-19 is having across all the traditional asset classes, a number of institutional investors are increasingly starting to allocate funds towards alternative asset classes.

As a result, the pricing levels among some alternative segments significantly inflated during the past 18 to 24 months. On the other hand, when looking closer into "beds and sheds" assets, the hospitality and retail markets have been going through one of the worst trading slowdowns in history and consequently are — arguably — at the beginning of a new cycle. Similarly, some of the well-located shopping centres and retail parks offer great repositioning potential into mixed-use assets, including logistics.

Therefore, given where some of the retail assets are trading (i.e. the United Kingdom), at Pro-invest Group we believe that this repositioning of assets provides a great entry point for getting exposure to other areas, such as flex-office space, build-to-rent (BTR), logistics, discretionary retail, as well as childcare.

Accordingly, we see plenty of opportunities arising in selective hospitality, commercial and retail investments, where repositioning allows one to take advantage of the current market volatility.

Pro-invest Group's integrated business model covers asset management, development and refurbishment, as well as day-to-day operations, allowing us to leverage the current market landscape and benefit from dislocated assets. Pro-invest Group's senior management team has been actively working in the commercial, residential, hospitality and retail investment sectors over the past three decades and, combined, members bring more than 290 years of real estate experience. Some of the world's largest institutional investors entrust Pro-invest Group with the management of their assets in the form of investment into funds, managed accounts and co-investments.

Post-pandemic opportunities arise

During the past two years, investors have witnessed significant economic disruptions for the hospitality and tourism industry. That said, those willing and able to look beyond the short-run impacts of the current crisis could stand to do well. Irrespective of the grim analysis of, and predictions for, the sector following the COVID-19 outbreak, unique opportunities are emerging to access quality assets across Asia Pacific and Europe — especially for dislocated assets.

In particular, COVID-19 has impacted hotel cashflows harder than any other real estate sector and presents a rare opportunity to secure discounted luxury, upper-upscale and upscale hotel assets at scale and preferred-equity positions. The hospitality sector presents these unique investment opportunities on the back of financial stress due to select owners' insufficient liquidity to support losses resulting in hotels being required to close, ramp-up and build occupancy.

At Pro-invest Group, we believe these scenarios will be exacerbated as banks re-evaluate their position and equity cures, or refinancing is increasingly required. COVID-19, therefore, provides a unique opportunity to enter the hotel market at an advantageous entry price or valuation, as we anticipate several high-quality but dislocated hotel opportunities to become available during the next 12 months.

More dislocated hospitality assets may be coming on to the market soon — a boost to deal flow and opportunities for fund managers well equipped to reposition struggling assets. To profit from the acquisition of distressed assets in favourable locations, though, asset owners will have to work harder to actively manage and reinvent assets to better capture demand when international travel resumes.[1]

Traditional asset-class outperformance

Once seen as a niche segment of the real estate market, hospitality has gained momentum to increasingly be viewed as part of the mainstream.

With COVID-19's disruption, the hunt for yield intensifies and more institutional capital is likely to flow into the sector. Pre-pandemic, private equity real estate fundraising into hospitality assets was robust, as per Preqin, with the quantity of capital secured by funds targeting hospitality having almost tripled (2.8x) since 2010, outpacing the global market (2.4x).[2]

Compared with traditional asset classes, such as office and industrial, hotels provide attractive high yields (when stabilised), which are of interest to global investors, especially in the current low-interest-rate climate, with bond yields achieving historical lows.

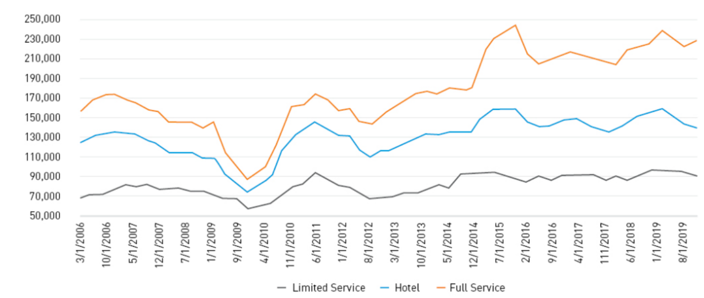
Key hotel markets across Europe and Asia Pacific boasted strong trading prior to the COVID-19 disruption, yet COVID-19 reduced revenue per available room (RevPAR) across markets by approximately 80 percent. Nonetheless, we note hotel recovery to be expected to return to 2019 levels across markets by 2023/2024. Positively, COVID-19's impact is projected to reduce new hotel supply, which will further enhance hotel trading in the medium term.

There is currently a bid/ask spread between buyers and sellers, which has reduced transaction activity in the market, although it is narrower, compared with 2020. While buyers are expecting an approximate 25 percent to 40 percent price discount to pre-COVID-19 values due to the prolonged recovery horizon and the lack of current available debt financing, sellers have been unwilling to transact at significant discounts to pre-pandemic values, having achieved short-term solutions to maintain liquidity, aided by a low-interest-rate environment, keeping debt-maintenance costs relatively low. This is when our integrated business model of in-house refurbishment/development, asset management and daily operations allows us to unlock opportunities, as we can execute on a well-considered asset repositioning, creating alpha returns, in addition to benefitting from a market recovery.

The most attractive hotel assets

At Pro-invest Group, we appreciate the appeal of select-service and midscale hotels, with Pro-invest Group having established two hotel funds dedicated to the rollout of quality select-service hotels with strong brand recognition. Select-service hotels is one of the fastest-growing hotel segments globally and is popular with investors,

Average sales price per hotel room, US$



Source: Featured in Preqin 2021: Real Capital Analytics in HVS, "*The Impact of COVID-19 on Hotel Values*", *April 2020*

as it is inclined to be more profitable and resilient in economic downturns. Indeed, these hotel assets have historically performed well in times of economic downturns, with COVID-19 being no exception.

That said, we also expect to see full-service hotels positioning as an attractive investment opportunity amid the economic disruptions triggered by COVID-19. This is partially due to their prominence in the hotel market relative to select-service hotels, more generally, coupled with the potentially larger impact of the pandemic on this hotel asset type.

When demand is disrupted, full-service hotels tend to record greater fluctuations in revenue and EBITDA [earnings before interest, taxes, depreciation and amortisation] than select-service hotels because of having to account for higher labour and other operating expenses. Further, average sales-price-per-room data indicates full-service hotel asset pricing to be more volatile relative to select-service hotels during economic downturns. Subsequently, this can lead to greater opportunities to obtain dislocated five-star full-service hotels at attractive discounts.

In the current environment, leveraging well-established branding is becoming more important and can offer unique upside potential for investors. Quality branding can ease the perceived risks faced by travellers by creating trustworthy, COVID-safe accommodations.

Hotel investment strategies

At Pro-invest Group, we have responded to the opportunity presented by COVID-19 with a strategic view to set up a hotel investment vehicle uniquely focusing on distressed hotel investment opportunities. Pro-invest Asia-Pacific Hospitality Opportunity Fund III (Fund III) is the successor of several hotel investment vehicles managed by Pro-invest Group, with a pre-COVID-19 track record of more than 20 percent internal rate of return. Fund III will offer core-plus and value-add luxury, upper-upscale and upscale hospitality opportunities, where Pro-invest Group can enhance cashflows through refurbishment and/or repositioning, improve revenue, and optimise operating efficiencies. Fund III will boast diversified geographic locations covering key Australian and New Zealand cities, focused on the gateway cities of Sydney, Melbourne, Brisbane and Auckland. An additional 30 percent of Fund III is allocated to pursue opportunities in Asian markets, such as Japan, Singapore and South Korea.

Our experience in the hospitality asset-management space has demonstrated that, provided hotels are skilfully acquired and actively managed, investments in hotels have the power to generate attractive yields and capital growth. Research demonstrates that hotels also have the capacity to outperform CBD office building investments on a risk-adjusted return basis. Regardless of movements in capitalisation rate and economic conditions, the hotel asset class can demonstrate consistency in income returns — when properly planned for cross-seasonal demand and targeting the right asset types.

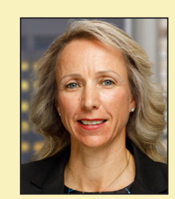
Purpose	Geographic investment focus	Real estate asset class focus	In-house team for design and development	In-house team for re-development	In-house operations	In-house asset management
By acquiring new sites or well-positioned assets at a discount to replacement cost, Pro-invest Group actively creates value-add through in-house development, repositioning, operation and asset-management capabilities.	Europe, Middle East, Asia	Commercial, residential, hospitality and debt	✓	✓	✓	✓

Notes:

[1] Preqin, "Hotels in Asia-Pacific: Investors Seek Bargains Even as Borders Stay Closed", July 2021; https://www.preqin.com/insights/research/blogs/hotels-in-asia-pacific-investors-seek-bargains-even-as-borders-stay-closed.

[2] *The Global Appeal of Hospitality Real Estate: A Preqin and Pro-invest Report,* November 2019.

CONTRIBUTOR



Dr Sabine Schaffer

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Pro-invest Group

Sabine Schaffer is managing partner and co-CEO Europe at Pro-invest Group and is one of the founding members of the firm. Since inception of the business, she was instrumental in establishing Pro-invest Groiup as one of the leading integrated real estate platforms within Australasia, covering all aspects of development, asset management and day-to-day operations. One of the biggest achievements is the positioning of Pro-invest Group as a leader when it comes to ESG, proven by the fact that all the assets within the Pro-invest Group estate to date are achieving some of the highest environment ratings (including the very first carbon-neutral hotel, according to NABERS ratings).

CORPORATE OVERVIEW

With a global presence, **Pro-invest Group** holds offices in Sydney, London, Dubai and Vienna. The firm has grown to be one of the largest investment and operating platforms in Australasia, with a strong presence in the Middle East, and it has most recently entered the European and UK region. As the recovery takes hold, the Pro-invest Group team is actively engaging with investment partners and asset allocators as the conduit to enable successful investments throughout the region, particularly focused on high GDP European markets. It plans to make these assets ESG compliant with local laws and regulations, pushing for industry leadership within sustainability for stakeholders to enjoy social and financial benefits.

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