
Holiday Inn Express Queenstown

FINDING THE SILVER LINING:

A NEW PERSPECTIVE ON HOSPITALITY AS AN ALTERNATIVE ASSET

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Hotel Indigo Brisbane

The term 'challenging' has been applied to almost every industry and sector over the past few years – and for good reason. We've been through an extraordinary period.

First, a global pandemic that confronted us in ways never thought possible, followed by a conflict in Eastern Europe with global implications, culminating economic instability, compounded by a difficult interest rate environment. Each on their own would have challenged the best of businesses. Together they have created turbulent uncertainty.

One of the industries in the eye of this storm is hotels. During the pandemic hotels were immediately impacted and almost as soon as they were forced to pause operations they reopened again - often at the request of governments and agencies amid pandemic response efforts.

Now, the industry has been navigating the inflationary pressures affecting staffing, energy prices, the supply chain and continuing interest rates. It's been a difficult three years to manage through and the headlines may make investing in hotels seem risky, complicated, and tough to navigate. But they only tell half the story and are many of the reasons why ultimately the hotel sector has long been under-appreciated and overlooked by traditional investors.

WANDERLUST NEVER WANES

In an era characterised by transformative shifts in consumer behavior, the fundamentals of the travel industry have proven to be not only resilient but robust. It would be challenging to find another sector with long-term tailwinds as formidable and promising as those that continue to propel the travel industry forward.

DISPOSABLE INCOME & RISING SPEND: Disposable income is high and younger generations are willing to spend above their means to pursue travel and upgrade their experiences[1]. Not only are Gen Z more likely to travel than other generations, but 61% of the most frequent travellers come from households with incomes of less than $50k[2]. In fact, a recent survey conducted by Bankrate shows that 56% of Gen Z and 59% of Millennials are willing to go into credit card debt to travel.[3]

MORE TIME FOR WORK AND PLAY: Bleisure. Digital Nomads. Workcations. Evolving work norms that embrace flexible and remote working have blended business and leisure. A new and growing wave of people are now seeking a greater number of travel-based experiences while working, bolstering demand for accommodation. Trips like these are up over 25% and have tripled in duration, with most long-haul travel now lasting for ten or more days[4].

GROWING DESIRE & PURPOSE: Gen Z is on track to surpass Millennials as the most educated generation in history [5]; and as such both Gen Z and millennials are increasingly seeking to travel to explore the world as part of their self-development process.

74% of American Express 2023 Global Travel Trends Report respondents agree they care more about creating a travel experience that meets their expectations than about the cost [6]; while 78% of respondents surveyed agree they see leisure travel as an important budget priority [7].

PROVEN RESILIENCE: Ultimately, as people continue to redefine the way they engage with the world around them this industry is a key beneficiary. This is proven time and time again as long-term global momentum always overtakes short-term shocks.

Travel and hospitality tend to rebound swiftly after-market corrections. The sector has constantly demonstrated resilience, durability and adaptability; and over the past 50 years hotels have consistently recovered more rapidly than other real estate asset classes.

2008 FINANCIAL CRISIS REBOUND

The U.S. hotel industry reached pre-crisis revenue per available room (RevPAR) levels by 2011, a recovery period of roughly three years. In contrast, residential property prices took nearly six years to recover [8].

PENT UP DEMAND POST-PANDEMIC

Global travel intentions are rising again. Morning Consult notes that in Europe 75% of people in Germany, Spain, and Italy plan to buy travel within the next year. In Asia, South Koreans rank highest [9].

Given the increasing pace of change in market dynamics, this resilience is particularly valuable as it implies that hotel investments are better equipped to withstand economic uncertainties.

Is this a reflection of our fundamental human needs for exploration, collaboration and experiences? That certainly plays a key role in understanding the strength of this sector. However, in this ever-changing landscape the industry's diverse and innovative nature and capacity to cater to changing consumer preferences are equally important.

GENERATIONAL SHIFT: The Mastercard Economic Institute stated that in the first quarter of 2023, spending on experiences is up 65% versus to spending on 'things' which is up 12%, compared to 2019 [10]. With a generational shift to value experiences over ownership (material possessions) the industry is poised to benefit once again from this transformation in mindset.

This experience-driven consumption is shaping the future of hospitality and further emphasises the opportunity of hotels as an asset class.

SHARED ECONOMY & CO-LIVING SPACES

The shared economy provides access to resources without the commitment of owning them.

Co-living is increasingly popular because it offers affordable, flexible and communal living arrangements, with shared spaces fostering social connections, collaboration and networking.

These spaces tick the box for mobility and flexibility, allowing residents to easily move between cities or countries without the burden of property ownership.

SUBSCRIPTION SERVICES & RENTING

This shift is also evident in the growing popularity of subscription services and renting options for everything from clothing to cars and entertainment.

For instance, clothing rental services like Rent the Runway and vehicle subscription services such as Zipcar cater to the desire for access without long-term commitment and financial burden.

This way consumers enjoy the benefits of diverse experiences while maintaining a more minimalist and sustainable lifestyle.

EXPERIENTIAL TRAVEL & CULTURAL IMMERSION

A higher value is being placed on unique and immersive local experiences - interacting with communities, and engaging in authentic cultural activities that provide a deeper understanding of the destination are prioritised.

This has led to a surge in experiential travel offerings, including boutique hotels and community-based tourism initiatives focused on delivering meaningful and memorable experiences.

HIDING IN PLAIN SIGHT

Most, if not all these industry tailwinds will not be new news to most investors. So why have hotels been an undervalued asset class for so long when the unique characteristics of this investment are so compelling:

01

VERSATILITY

Hotels provide versatile spaces that cater to a variety of needs, making them increasingly attractive to the modern consumer. They are no longer just a place to stay. They are evolving into dynamic, multi-use spaces that cater to a mixture of interests and requirements.

Lobbies turn into co-working zones, rooftops host wellness activities, and unused areas morph into art showcases or local artisan pop-up shops. Bars are networking platforms for events like industry talks or wine tastings, kitchens offer culinary workshops, and conference rooms transform into virtual reality gaming zones.

By embracing this shift and focusing on creating memorable, sustainable, and digitally integrated experiences, hotels are showcasing their versatility and securing their position as the asset class of the future.

02

INFLATIONARY HEDGE

Hotels offer a compelling inflationary hedge relative to other asset classes, primarily due to their unique 'daily leases' structure. This structure allows hotel operators to adjust room rates frequently, often daily, in response to market conditions and demand. Consequently, hotels can swiftly adapt to inflationary pressures by raising their rates, allowing them to maintain profitability and pass on rising costs to consumers.

Additionally, hotels benefit from their inherent diversification across various customer segments, including leisure and business travelers, which further bolsters their ability to bounce back from challenging market conditions. As different customer groups react differently to economic fluctuations, this diversification helps to mitigate risks and maintain a steady revenue stream for hotel operators and investors.

03

FUTURE-PROOFING POTENTIAL

Over 50% of Australian hotels are over 40 years old. Europe faces a similar trend, with many hotels needing renovations.

As ESG regulations tighten and consumers seek responsible spaces, owners must invest to remain competitive and win over the next generation of customers. In a recent study of Gen Z and Millennial travellers, the majority state they pay more for companies and experiences that "adopt environmentally friendly philosophies and practices" [11].

The additional CAPEX requirements present an opportunity to ensure viability and sustainability. Simultaneously investors can enhance their ESG credentials, unlock value through operational efficiencies, sustainable practices, and an improved guest experience. This contributes to the hotel industry's transformation and capitalises on its growth potential, positioning investors for long-term success and strong ROI.

04

ALPHA ABILITY

Hotels present unique operational dynamics to help outperform the market. Unlike many other real estate assets, hotels operate seven days a week, 365 days a year, resulting in exceptional efficiency. This is especially notable when contrasted with usage rates of offices in the post-pandemic era.

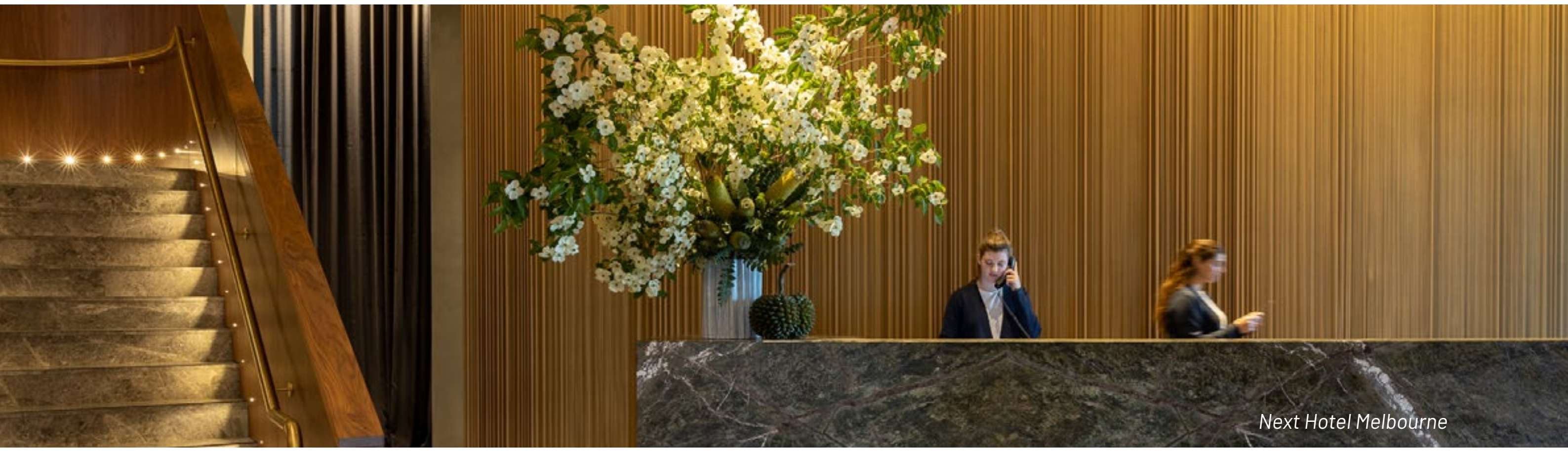
Hotels generate a wealth of daily data with valuable insights into consumer behaviour, demand patterns, and pricing. This becomes a powerful tool when managing revenue and costs by dynamically adjusting rates during peak and slower periods, proactively managing staffing, maintenance, or utilities, and investing in energy-efficient technologies.

Moreover, managers can enhance guest experiences and build customer loyalty in a competitive market by utilising feedback, online reviews, and social media analytics, to continuously improve products, services, and marketing strategies.

05

NOT INSTITUTIONALISED (YET)

Institutional ownership amongst hotels is lower than other real estate asset classes, resulting in restricted financing abilities, especially with rising interest rates. So, when purchasing from single asset owners, institutional investors often identify significant areas for improvement and create efficiencies in operations that present substantial value-add opportunities.



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UNPRECEDENTED MARKETS CONDITIONS

During the pandemic, hotels were among the least favored asset classes to enter due to their operational nature. As a result, their ***capitalisation rates*** (cap rates) did not experience extensive compression, unlike residential and logistics. This scenario suggests that even if cap rates increase in the future, they might see milder rate expansion levels compared to other classes that have experienced significant corrections in the past six months.

Many single-asset hotel owners without institutional backing are now motivated sellers. In 2022 they benefitted from the bounce of high trading performance. While this might have met the Interest Coverage Ratio (ICR) covenants last year, 2023 could be different. Banks which have not dealt with ***Non-Performing Loans*** (NPLs), will need to address them in the next twelve months, creating opportunities for investors to acquire these assets at potentially favorable prices.

At the same time, the ***deceleration of hotel supply growth***, coupled with continued pent-up travel demand, is creating the right dynamics for increased hotel investment opportunities. Globally, new hotel supply growth has slowed significantly since the onset of COVID-19. The APAC region saw a 5.1% reduction in supply growth in 2022, compared to 2019 [12]. This limited supply across the region is expected to continue over the medium to long term with a low 2022-2025 CAGR of 2.8% [13].

Hotels globally are seeing positive growth compared to other asset classes. In the US for example, hotels were the only real estate asset class to show positive quarterly returns from Q2'22 to Q1'23 [14] and in contrast with industrial, offices, retail and residential, hotel values across Europe rose by an average 3% in 2022 [15].

So current market conditions present a convincing opportunity for real estate investors to capitalise on hotels as an asset class. With motivated sellers, the inflationary hedge, value-add potential and attractive cap rates, hotels can offer a lucrative investment opportunity for those willing to tap into the market's unique dynamics.

The Sebel Canberra Campbell

AN INTEGRATED PLATFORM IS KEY

Hotels are complex assets. Historically that has created wariness amongst some institutional investors, but this is where Pro-invest Group sees opportunity.

Over decades of experience, we have built an integrated platform that generates tangible value creation for investors by combining hotel development, day-to-day hotel operations and active asset/fund management. It is this integrated approach that delivers a more attractive risk/return profile for investors. With this model Pro-invest Group are well positioned to either build new developments, renovate and reposition older hotel buildings or repurpose office or retail assets into hotel or mixed-use properties. It is also core to the way the company approaches residential living assets including Build-to-Rent and Co-living.

While the hotel industry faces its share of challenges, it holds a favourable position relative to other asset classes and stands to gain from the existing difficulties plaguing them. The predicaments of office buildings grappling with low occupancy rates, coupled with the issues surrounding obsolete structures failing to comply with ESG requirements, present Pro-invest Group with golden opportunities to transform them into value-added hotel conversion projects.

This is not to diminish the continuing challenges faced by the industry. Particularly labour shortages, rising costs and ongoing economic uncertainty impacting consumer spending. These are very real and significant issues, but the industry is not alone in needing to solve these.

At Pro-invest Group we focus on developing proactive, sustainable solutions to relieve some of these pressures. For example, our centralised operating model minimises overall permanent workforce requirements and prioritises guest facing roles on property. This way we mitigate the impact of labour shortages, while maximising profit and ROI through scale efficiencies across the portfolio.

IT'S TIME TO CHECK-IN

Our discussions with investors and asset owners over the last nine months have compounded our view that those seeking to protect their portfolios from inflationary pressures and capitalise on the robust recovery potential of the hotel industry should consider hotels as part of their future portfolio.

The long-term trends are evident and have been proven time and time again. Now, combined with the unique characteristics of the asset class and current market conditions, there is a compelling case to re-look at investment in the sector and act now to maximise this opportunity.

Hotels are the silver lining in any portfolio of assets. Now is the time for investors to recalibrate the view of hotels as an 'alternative' asset class and consider these properties as a key component of any real estate investment strategy.

Voco Auckland

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