HOTEL FUTURES 2020

COVID-19 UPDATE SERIES

INTRODUCTION TO THE SERIES

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Introduction to the Dransfield Australian Hotel Market COVID-19 Update Series

As we get more information about the effects of COVID-19 at both the health and economic levels it enables us to start thinking a little bit more about the longer term.

We have started modelling revised major city forecasts from the Hotel Futures series, adopting a different, more granular, monthly format for the current circumstances. This is essentially a baseline estimate with upside sensitivity analysis so that we understand where the boundaries might be, based on current knowledge.

If there is one thing this virus has taught us, however, it is that current knowledge is out of date the moment we have finished analysing it. Nevertheless, we can't let a high level of uncertainty lead to an equally high level of in-action, so we think it's still best to make a reasonable estimate and have a plan.

So we start with what we know, or think we know, and try to understand the potential effect of what we know less about. Below we summarise our general thinking and outline a possible outlook. This series will forecast a base outlook for each of the 10 markets covered in our typical Hotel Futures Series, with each market released as they are ready, each few days. Where there have been significant changes to the environment, we will periodically update.

More detail on individual markets and how this forecast will affect individual hotels can be obtained by contacting us. Please also join our free database to receive all future market intelligence publications.

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COVID-19: Overview of the Effect on Australian Hotels

We expect the pandemic will progress through all CBD hotel markets in a similar fashion. Particularities such as market mix (Dom vs Int, business vs leisure), supply pipeline and RevPAR position between each market will shift the emphasis somewhat, either helping or hindering the downturn and recovery. There are related forces of Supply, Demand and Rate which interact. We anticipate the relationship to follow the path below

1. Immediate demand reductions from travel restrictions and social distancing
   - Substantially lower occupancy and lower rate
   - Lower short term earnings and immediate valuation impact
   - Some hotels will shut, some won't re-open

2. Lower medium term demand, and a supply pipeline recalibration
   - Hotel development feasibility is now more challenged. Constructions will delay or fail, proposals and future projects won't eventuate at the same speed or volume
   - Reduced longer term demand consequences as a result of GDP/global wealth destruction, and this new environment takes multiple years to recover whilst there is inadequate occupancy pressure to reclaim rate losses

3. How this will impact individual hotels
   - Focus on cost cutting to reset cost structures to lower volume and revenue
   - Debt and equity restructuring

Dransfield COVID-19 Market Outlook Series: Theoretical Forecast Overlay for all CBD's

Demand Assumptions

- In early 2020 we had developed a "pre-COVID-19" demand forecast which established a baseline demand curve. This was based on FY2019 actual annual visitor night data with growth rates determined using our typical Hotel Futures forecasting methodology
- Demand will now be materially adversely affected, for a likely period of 9-18 months (which began in Feb 2020), initially to a much higher degree as border and social controls limit both International and Domestic movement
- We have assessed demand reduction, by month, in three categories including Chinese sourced nights, all other International visitor nights, and Domestic nights, until December 2021 and based on the relevant market mix
- The recovery will be gradual and in stages as travel restrictions and social distancing measures are lifted. There remains uncertainty about when these will start within a probable 3-9 month window, and how long it will be before we are largely unrestricted, with International markets taking much longer than Domestic
- We assume that from FY2022 onwards (July 2021,) there are no travel restrictions or social distancing measures in place. From this point on, we revert to the "no COVID-19' base case demand assumptions, however apply a discount factor of 5-10%. This allows for a lowered base and changes in visitor behavior as a result of the global economic destruction and structural change in the travel and business community. This discount factor closes over the next few years but does not fully catchup to prior expectations
- Our sensitivity scenario, assumes travel restrictions and social distancing measures are lifted quicker, with domestic visitor nights leading the way, and lower levels of rate reductions.

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Supply

Supply will recalibrate and reduce to the new demand environment offsetting some demand losses. This will happen in three ways:

- Some hotels will close temporarily, some permanently
- Construction and proposal activity will slow and in some cases cease. This will result in a reduction to the medium term supply pipeline
- Additional projects allowed for in the long term forecast, but not yet conceived (Market Response), won't eventuate at prior expectations (volume/timing) as development feasibility hurdles are tougher to reach

The position in the supply development lifecycle will affect how fast a city may recover over the medium term

- Those at the end of the supply cycle have limited capacity to flex down (Perth/Brisbane)
- Those that have high levels of proposals and Market Response, and low levels of construction have the greatest capacity to recalibrate (Sydney and Adelaide)
- Those which have large committed pipelines under construction and proposals will see much less change (Melbourne)

Our core supply assumptions include:

- 25% of supply under construction will be delayed by 12 months. At this time we have not made an assumption that any under construction projects stop however that will likely happen for some projects
- We have assumed a circa 50% reduction in net proposal completion, compared to our pre-COVID-19 expectations (which were often based on 50% or below probability)
- Market Response (MR) allowances have been scaled back as the occupancy/revenue development targets are not triggered. MR is now nominal over the next 5 years

Rate

There will be material downward pressure on rates as long as demand is impacted and competition for guests is high. This is likely to sustain over the medium term in many cities.

- Our FY2020 assumption takes regard of 9 months pre-COVID-19, relying on STR data. We assume a circa 15% reduction for the remainder of the year which is inline with STR data at the time of the forecast
- We anticipate FY2021 rates will remain challenged through the first 3 quarters, before discounts begin somewhat unwinding as we move through the calendar year and the months already impacted in FY2020 are the new baseline. Rates will be adversely impacted by the reopening of closed hotels, from a cold start, in low occupancy markets
- The lower market occupancy position through this period, compared to prior expectations, and higher competition for a smaller pool of guests, is likely to inhibit rate growth until supply recalibration occurs and occupancy pressure returns in the latter part of our long term forecast

This broad assessment of market forces and assumptions are assessed at a more granular and specific level for individual markets. Whilst these market tools are a helpful starting point, and reference tool, it is important to look at your individual circumstances. We have developed site specific forecasting tools at both the revenue, and, net earnings after interest levels, to deal with this very unusual environment. Please contact us for more information.

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Important Note:
STR figures will differ from ours as they have chosen not to include data for hotels that have temporarily closed during the pandemic, effectively recording a change to Supply, rather than our approach which carries the full impact in reduced occupancy. Our methodology assumes that these hotels will reopen at some point in the next 3-9 months. **Our data will display lower occupancy levels and lower RevPAR** than the STR dataset moving forward as a result

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