HOTEL FUTURES 2020

COVID-19 UPDATE SERIES

PART 1 - MELBOURNE & SYDNEY

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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If there is one thing this virus has taught us, however, it is that current knowledge is out of date the moment we have finished analysing it.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.

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

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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See Overarching Theoretical Market Overlay before reading individual Market Outlooks

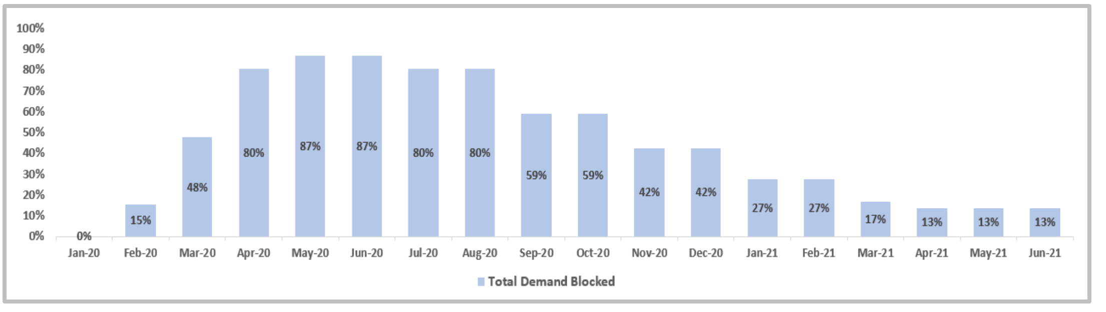
Melbourne Market Outlook: COVID-19 Market Outlook Series

Melbourne hotel occupancy has been consistently strong, sitting in the mid to low 80's for several years. Rate growth has been restrained by competition from a significant increase in unregulated residential short stay apartments. The market is midway through it's supply lifecycle with a significant amount of committed hotel projects under construction and due to arrive over the next 3 years. This follows material supply over the prior 2-3 years. Rate growth has also been soft as these rooms were absorbed, however, occupancy has held up well. Our prior edition of Hotel Futures 2019 forecast 0.6% average growth in the three years to FY2022 as new supply was absorbed improving to 3.1% p.a over the longer period to FY2027.

Demand Outcome

Our short term forecast for demand reduction (for the next 15 months) compared to our pre COVID-19 demand scenario is presented below in this 65% domestic market.

Melbourne – Forecast Demand Reductions from Travel Restrictions and Social Distancing



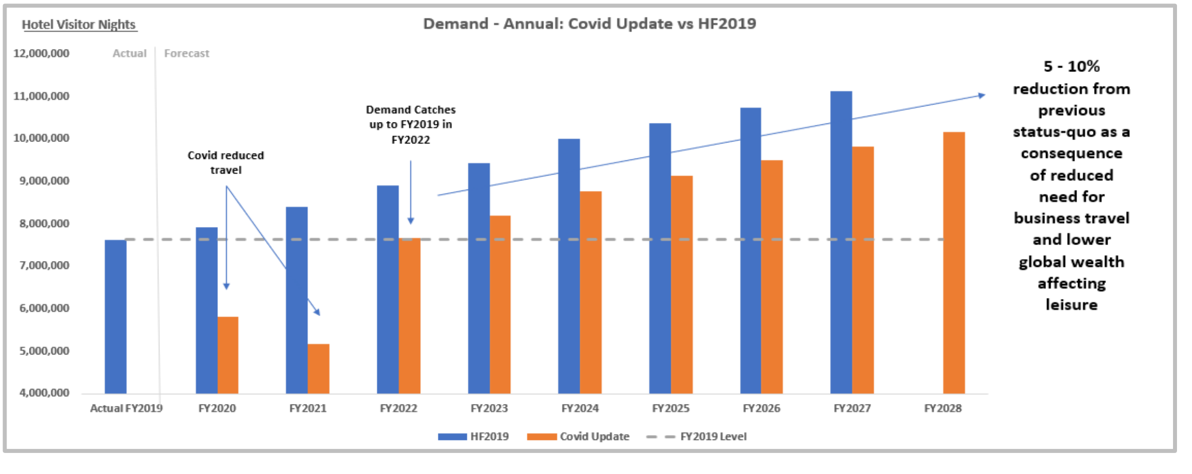
Short-term Outlook (next 12-18 months)

- Reduction to normal demand is minor in February as only Chinese sourced nights were blocked through this month. In Melbourne, Chinese nights make up circa 7% of total nights.
- Reductions build through March and April as more pronounced social distancing measures were put in place, stopping all International travel and most interstate Domestic travel. Quarantine guests and government make up the majority of demand for the back end of these months
- Reductions peak through May/June, as only essential travel is likely to be permitted and quarantined returning overseas visitors is more limited
- We anticipate more widespread domestic travel will begin from July as restrictions progressively ease returning to almost 75% of prior expectations in about November 2020
- We don't anticipate significant international restrictions to start to ease until September, and we expect these to be on a country by country basis, achieving 50% of prior expectations in about January 2021 and less than 25% prior to year end. This could easily slide three months.

Longer-term Outlook

Our long term Melbourne demand forecast is presented below. We compare it to our Hotel Futures 2019 demand assumptions formed in April 2019.

Annualised Demand Compare – Pre and Post COVID-19 Outlook



- FY2020 demand falls approximately 20-25%, with only 4-5 months COVID-19 affected
- FY2021 demand remains blocked/reduced, albeit improving as we move to later months
- As the vast majority of travel restrictions are lifted in FY2022, demand returns to near FY2019 levels, albeit, does not reach previous growth expectations due to the economic and health damage caused
- Demand absolute numbers will continue to grow, although are likely to remain two-three years behind prior expectations.

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Melbourne Market Outlook: COVID-19 Market Outlook Series

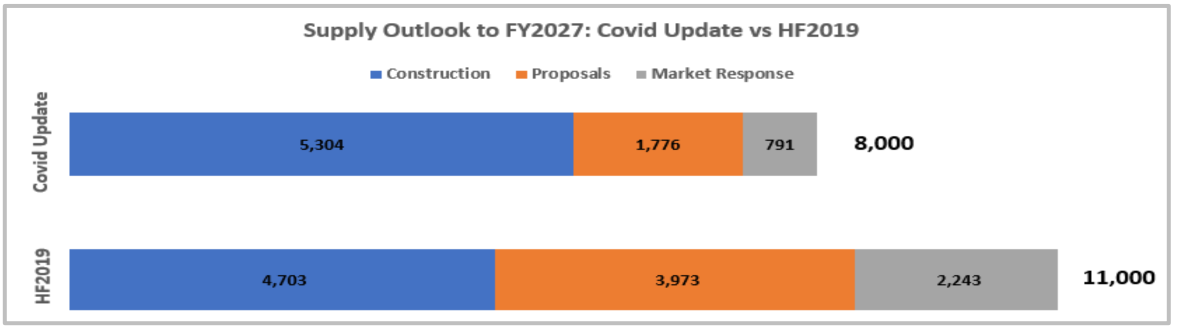
Downward Pressure on Rates

- FY2020 second half rates are expected to be around 15% below 2019 rates post March 2020, using current STR data as the barometer
- FY2021 is likely to continue in this vein, recovering slowly as travel restrictions ease, but not completely due to weak demand, low occupancy, hotel re-openings and a fragile economy. We expect Melbourne rates will start to record growth from about March 2021 compared to the weakened March 2020
- FY2022 should start to see more significant recovery, despite the added pressure of material supply arrivals. We expect a swift unwind as current rate discounting eases. This could mean double digit growth in FY2022, albeit from the much lower base.
- This would see rates recover to FY2019 levels in FY2023

Supply Response and Effect on Occupancy

Supply will recalibrate to the new demand environment as revenues and feasibilities are impacted.

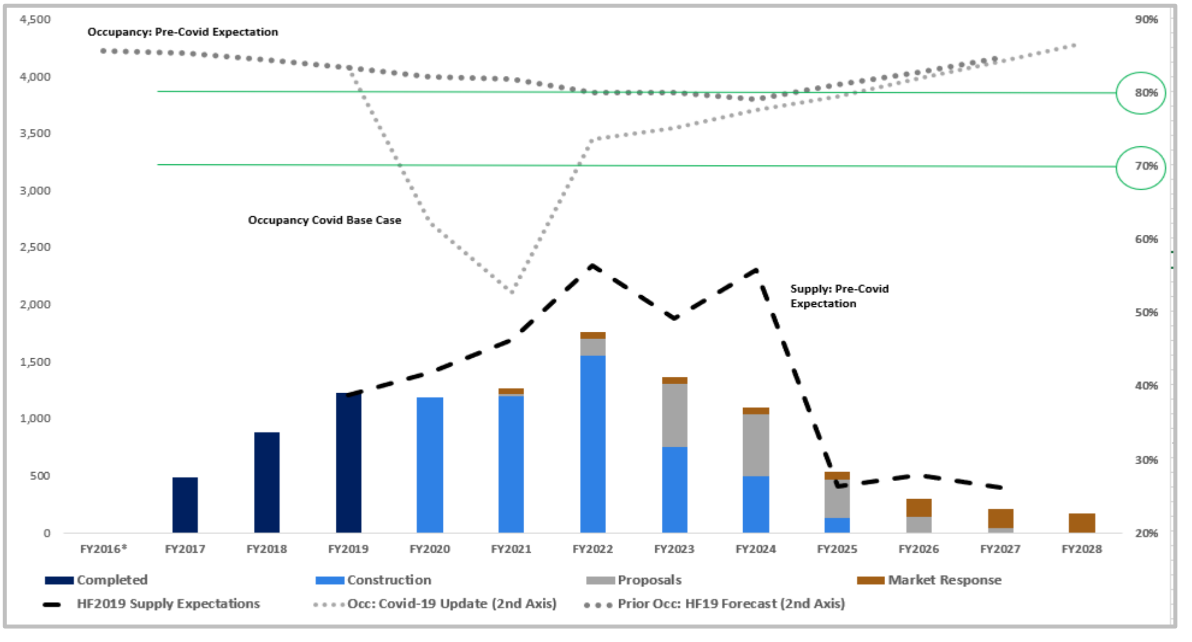
Melbourne Supply Pipeline by Type – Long term 9 years



We expect 8,000 new rooms to arrive over the long term to FY2028. This is circa 3,000 less rooms than the prior forecast on a current base of 25,000 rooms. The vast majority of Melbourne supply is in construction and is fairly well progressed.

A comparison of the revised supply expectations and the resulting occupancy is presented below

Supply Pipeline by Type and Occupancy Overlay – Long term 9 years



- Melbourne occupancy for FY2020 is likely to end 20-25 percentage points lower than the prior year. We expect annualised levels to finish at 60-65%
- Under our demand scenario, occupancy will contract further in FY2021 as travel restrictions and social distancing persists at some level for much more of that year. We expect a further 5-10% reduction, ending the financial year at an annualised 50-60%
- FY2022 will likely see a big recovery as demand blockages unwind. We anticipate, market occupancy will increase to 70-75%
- Occupancy levels should close the gap compared to pre-COVID-19 expectations, over the next few years, as demand returns and the effect of the supply recalibration kicks in.

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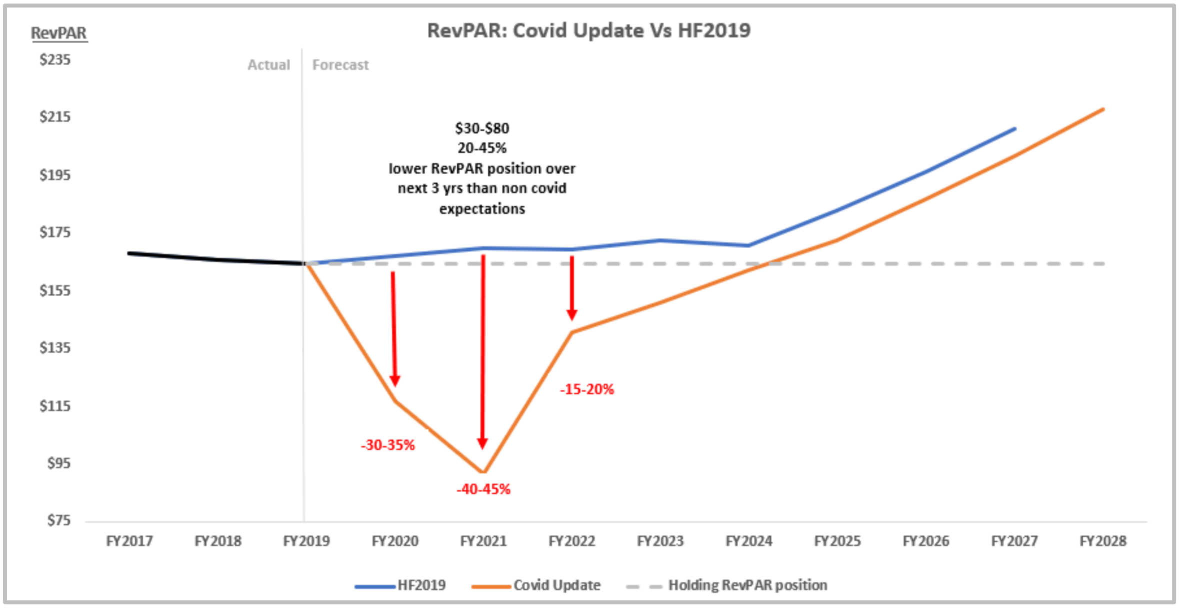
Melbourne Market Outlook: COVID-19 Market Outlook Series

RevPAR Impact

- RevPAR destruction over the next 12-24 months will be significant.
- We anticipate 30-45% reductions to prior expectations over this period ($50-80), with the RevPAR forecast over 15% lower for the full period to FY2027, however, mostly recovered to below 5% from FY2024



- We have also tested the impact of an improved recovery period. This includes:-
  - Accelerating the elimination of travel restrictions and demand damage
  - Accelerating the rate recovery
- This reduces the short term RevRAR damage to 30-35% ($50-60), with almost full recovery by FY2024, however the long term forecast still remains 11% below our prior Hotel Futures 2019 expectations. At present this feels optimistic.

This Individual market snapshot should be read in conjunction with our Introduction to the Australian Hotel Market COVID-19 update

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Sydney Market Outlook: COVID-19 Market Outlook Series

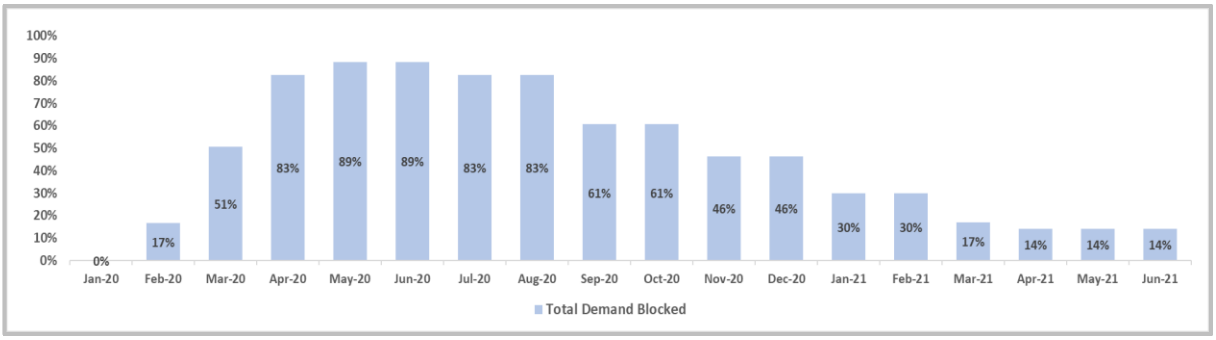
Sydney hotel occupancy has been consistently strong, sitting in the mid 80's for several years. Rate growth has been inexplicably restrained despite far less residential apartment competition than Melbourne, and less supply.

The market is earlier in it's supply lifecycle than most markets, with only 25% of the long term pipeline under construction last year. Our prior edition of Hotel Futures 2019 Forecast 1.1% average RevPAR growth in the three years to 2021 and 3.2% over the period to 2027

Demand Outcome

Our short term forecast for demand reduction (for the next 15 months), compared to our pre-COVID-19 demand scenario, is presented below in this 57% domestic sourced market.

Sydney – Forecast Demand Reductions from Travel Restrictions and Social Distancing



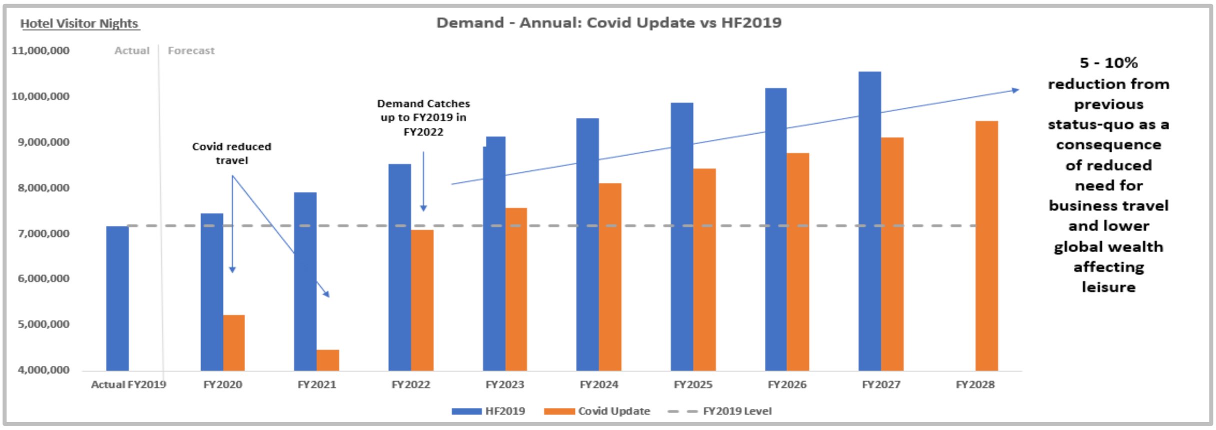
Short-term Outlook (next 12-18 months)

- Reduction to normal demand is minor in February as only Chinese sourced nights were blocked through this month. In Sydney, like Melbourne, this is 7% of total nights
- Reductions build through March and April as more pronounced social distancing measures were put in place, stopping all international travel and most interstate domestic travel. Quarantine guests and government make up the majority of demand for the back end of these months. Sydney's high International content of 43% increases its exposure to this slower returning market
- Reductions peak through May/June, as only essential travel is likely to be permitted and quarantined returning overseas guests are more limited
- We anticipate more widespread domestic travel will begin from July as restrictions progressively ease returning to 70% of prior expectations in about January 2021
- We don't anticipate significant international restrictions to start to ease until September, and we expect these to be on a country by country basis achieving circa 50% of prior expectations in about January 2021 and less than 25% prior to year end.

Longer-term Outlook

Our long term Sydney demand forecast is presented below. We compare it to our Hotel Futures 2019 demand assumptions, formed in April 2019.

Annualised Demand Compare – Pre and Post COVID-19 Outlook



- FY2020 demand falls approximately 25-30%, with only 4 months COVID-19 affected
- FY2021 demand remains blocked/reduced through the first half before recovering
- As the vast majority of travel restrictions are lifted in FY2022, demand returns to near FY2019 levels, albeit, does not reach previous growth expectations due to the economic and health damage caused
- Demand absolute numbers will continue to grow, although are likely to remain about two years behind prior expectations.

Sydney Market Outlook: COVID-19 Market Outlook Series

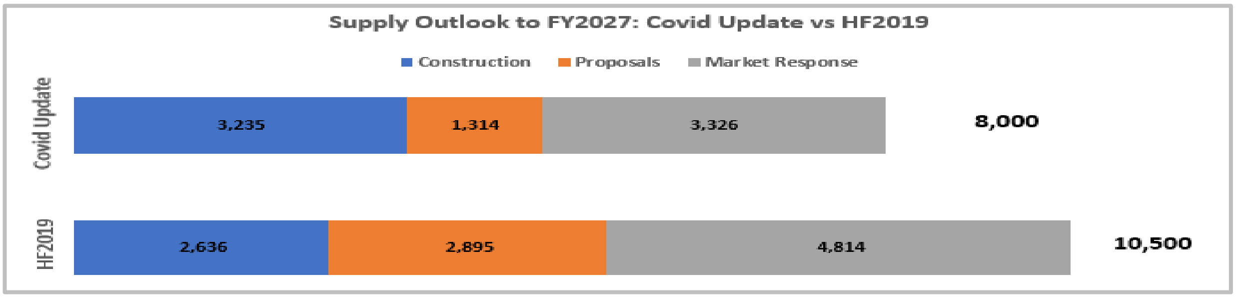
Downward Pressure on Rates

- FY2020 second half rates are expected to be at least 15% below 2019 rates post March 2020, using current STR data as the barometer
- FY2021 is likely to continue in this vein, recovering slowly as travel restrictions ease but not completely due to weak demand, low occupancy, hotel re-openings and a fragile economy. We expect Sydney rates will start to record growth from about March 2021 compared to the weakened March 2020
- FY2022 should start to see more significant recovery, despite the added pressure of more material supply arrivals. We expect a swift unwind as current rate discounting eases. This could mean higher rate growth in FY2022 of say 8-10%, albeit from the much lower base.
- This would see rates recover to FY2019 levels in FY2023

Supply Response and Effect on Occupancy

Supply will recalibrate to the new demand environment as revenues and feasibilities are impacted. In Sydney there is greater opportunity for this than most markets as it is earlier in its supply cycle, with higher levels of Market Response and proposals, that can be delayed or cancelled compared to Melbourne.

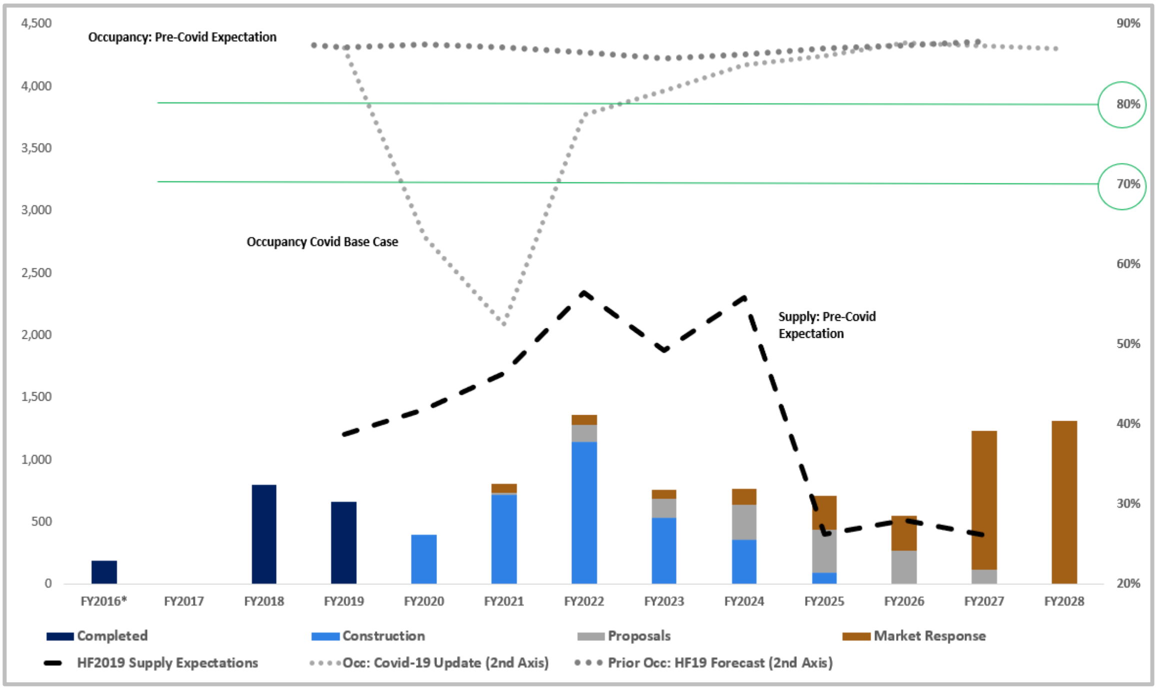
Sydney Supply Pipeline by Type – Long term 9 years



We expect 8,000 new rooms to arrive over the long term to FY2028. This is circa 2,500 less rooms than the prior forecast on a current base of 22,500 rooms

A comparison of the revised supply expectations and the resulting occupancy is presented below

Supply Pipeline by Type and Occupancy Overlay – Long term 9 years

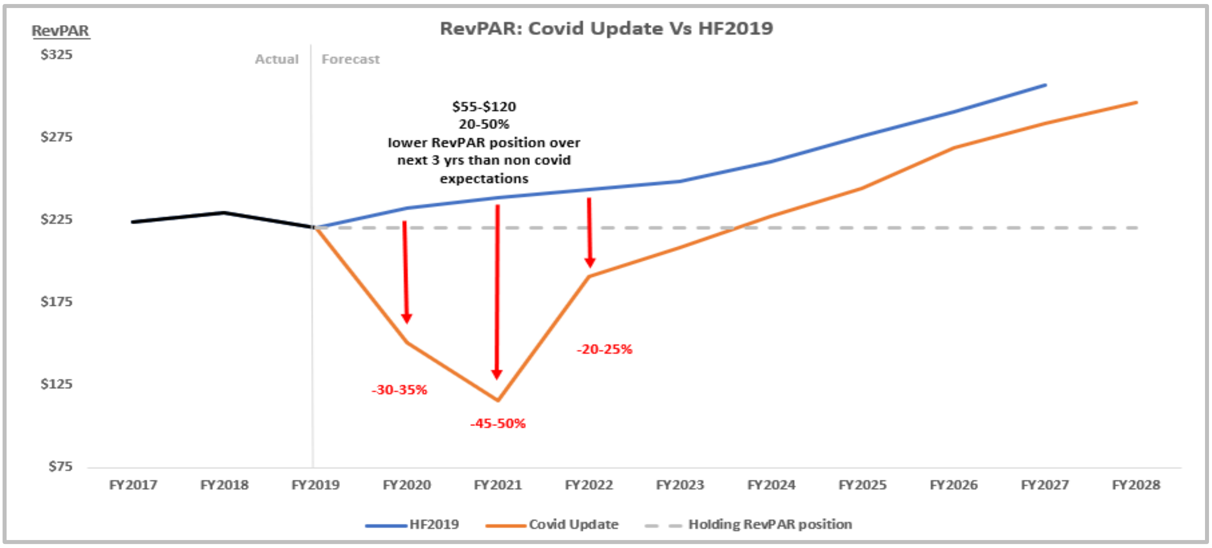


- Sydney occupancy for FY2020 is likely to end 20-25 percentage points lower than the prior year. We expect annualised levels to finish at 60-65%
- Under our demand scenario, occupancy will contract further in FY2021 as travel restrictions and social distancing persists at some level for much more of that year. We expect a further 10% occupancy reduction ending the financial year at an annualised 50-55%
- FY2022 will likely see a big recovery as demand blockages unwind. We anticipate, market occupancy will increase to say 75-80%
- Occupancy levels should close most of the gap, compared to pre COVID-19 occupancy expectations, over the next few years, as demand returns and the effect of the supply recalibration kicks in.

Sydney Market Outlook: COVID-19 Market Outlook Series

RevPAR Impact

- RevPAR destruction over the next 12-24 months will be significant.
- We anticipate 30-50% reductions to prior expectations over this period ($80-120) with the RevPAR forecast average expected to be just under 20% lower for the full period to FY2027, albeit skewed to the next 3 years. In FY2027, we expect to be 5-10% behind on an absolute basis



- We have also tested the impact of an improved recovery period. This includes:-
  - Accelerating the elimination of travel restrictions and demand damage
  - Accelerating the rate recovery
- This reduces the short term RevPAR damage to over 40% with almost full recovery by FY2026. In this scenario, however, the long term forecast remains 15% below prior long term expectations.

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