Colliers Hotels Insight
A quarterly digest of key trends in the hospitality sector

Inside this quarter:

HOTELS – New Year New Challenges

LEISURE – Gaming in Japan, the new El Dorado?

OPINION – IFRS 16 Update – Accounting for leases in the hospitality sector
Foreword

Welcome to our first edition of Colliers Hotels Insight, our new quarterly magazine specifically for hotel and other accommodation stakeholders across Asia. The magazine will feature key trends in destinations across Asia, a highlight of key industry disruptors and a technical section. This magazine will also provide insights and opinions on topical issues within the gaming sectors.

In our first edition we take a brief look at hotel performance across Asia together with selected Pacific locations, and an outlook for 2017. Our technical section provides a brief look at the requirements of IFRS16 which may impact all entities that currently have operating leases in place. In our leisure section, we look at the implications for gaming investors as a result of the recent legalization of gaming in Japan.

2016 could be seen as the year where political risk once again reminded us that it is very much alive. The so-called Brexit, the election of Donald Trump and the return of populism, and the growing demand for action has left global markets in turmoil. Oil prices and geopolitical issues, together with the decoupling of monetary policy across the developed nations weighed on performance and decision making. This in turn had an impact on asset pricing, foreign currency movements and investment. But how many of the factors affecting investment decisions are cyclical, and how many are due to structural issues? Are we clouding the two?

We expect 2017 to remain turbulent, with short-term decisions continuing to cloud longer-term outlooks, at least in the first half of the year. In the latter part of the year (Q4), as the reward for investing now outweighs the risk of doing nothing, bold investors will drive decision making as they seek higher returns on capital.

In brief, the outlook for hotels across Asia will remain cautiously optimistic, with emerging markets providing the best investment opportunities. In mature destinations, RevPAR is likely to remain at low or even negative growth levels as markets peak, and new supply enters the market. Yield maximisation will become even more prevalent, with the focus on cash flows even keener.

We expect the leisure sector in the Region to continue to change and adapt to new experiences required by the evolving Asian traveller. However, the advent of “build it and they will come” may have well passed and investors will need to adopt a well-informed approach to new projects and investment opportunities.
Colliers Hotels

Colliers International launched its specialised hotels division in 1985 and today it provides expertise in capital valuations, management agreement and transaction advisory services, in addition to brokerage. Within the Asia Pacific region we have dedicated hotel specialists based in Australia, Hong Kong / China, India, Singapore and Thailand.

We regularly act on behalf of major institutional property owners / funds for their valuation needs, from single strata units to composite developments and golf courses, for all purposes, including IPOs, listings, acquisitions, disposals and mergers.

In Asia, the team of professionals has provided hospitality services throughout the Greater China region including the Mainland, Hong Kong, Macau and Taiwan, and also in Bangladesh, Cambodia, Guam, India, Indonesia, Japan, Korea, Laos, Malaysia, Maldives, Myanmar, Pakistan, Philippines, Singapore, Sri Lanka, Thailand, and Vietnam. Our sizeable hotels, hospitality and leisure team includes specialists, many of whom have worked at a senior level in the sector, giving us a unique advantage and insight.

Clients are assured that the services of a multi-lingual and multi-cultural team of highly qualified professionals will assist them to achieve their real estate goals. Colliers’ professionals have extensive operating and consulting experience in the hospitality industry across the major asset classes, which provides clients with extraordinary value and a single point of contact, through timely, relevant and forward-looking advice. This global division has exceptional relationships with investors worldwide, required for the timely and effective sale of assets. In addition, they have worked with a wide range of clients including corporate hotel clients, private equity, sovereign wealth funds, independent owners, REITS, governments, and banks.

Our Services

Whether you are a first time or well established owner developer or investor, at Colliers we will be able to assist you throughout the business life cycle. We are here to provide specialist, value added advice that is tapered to your specific needs. This includes:

> Market Demand and Feasibility Studies
> Valuations – Property and Business
> Plant and Machinery Valuation
> Impairment Testing
> Capital Markets
> Due Diligence
> Internal Business Reviews
> Operator Search and Select
> Benchmarking and Forecasting
> Growing the business: extensions, refurbishments, brand roll out and expansion
> Asset Management
> Business Restructuring – opco/propco
> Needs Analysis / Economic Impact Studies
> Highest and Best use / Concept Designs
> Transaction Advisory, IPO and REITS listing
> Management Agreements and Lease Reviews
> Litigation Support and Dispute Resolution Project Management and Leasing
> Tourism Strategy and Master Planning
Our Hospitality Sectors

Colliers track record covers all the main asset types including hotels, resorts, heritage properties, serviced apartments, student accommodation, hostels, vacation homes, casinos, theme parks, spas, and golf. These could be for either completed projects or new developments. Our specialised sector expertise includes:

> Hotels and Resorts
> Hostels and Student Accommodation
> Golf
> Casinos and racecourses
> Health and Fitness
> Spas and Wellness Facilities
> Meetings and Events
> Mixed-used Developments
> Travel Trade
Hotel Trends

New Year, New Challenges

Tourism arrivals to the Asia Pacific region are expected to grow by 9.0% between 2015 and 2016, continuing a steady period of growth witnessed since 2010, following the fallout from the global financial crisis.

An analysis of the data over the last 10 years, tourism arrivals across the region is highly correlated to that of World economic performance (correlation factor of 0.87). This indicates the region's high susceptibility to consumer confidence at a global level. Looking closer, the impact of China's economic growth on tourism arrivals is beginning to slow as the country adjusts to a new level of performance as it matures. This is coupled with the Mainland's continued efforts to dampen conspicuous spending. Between 2007 and 2011, China's economic performance had the most impact on tourism arrivals (0.57), with this dropping away (0.20) by the end of 2016. We expect the focus to turn fully to China's significant domestic market, especially as the yuan remains weak and capital controls remain in place.

Perhaps encouragingly, however, collectively Emerging and Developing Asia, which includes China, continues to underpin tourism growth. This is unsurprising and we would expect this to continue to be the case as per capita income rises across the region.

RevPAR growth in the region is closely correlated to that of economic performance in Emerging and Developing Asia. This highlights the importance of intra-regional and domestic tourism to destinations, the latter of which is sometimes overlooked. On average, in 2017 we expect RevPAR growth to continue to be impacted by foreign currency movements, the further evolution of low cost carriers (LCC) and the destinations they serve, together with economic performance and consumer confidence in key source markets.

According to a survey by Carlson Wagonlit, a travel company, the best performing sector for 2017 is expected to be MICE.
Key trends for 2017

Foreign currency movements - US interest rate policy will continue to influence currency movements across the Region, with weaker currency destinations likely to continue to benefit from inbound travel. Destinations with appreciating currencies are likely to witness some contraction in ADR growth. US interest rates seem to be on an upward path. President Trump has inherited a strong economy poised for continued moderate growth. The planned stimulus package of tax cuts and infrastructure spending should boost growth, but at the cost of higher inflation and interest rates.

LCC - the impact of low cost carriers has had a dramatic effect on tourism arrivals in recent years (take a look at Singapore when it expanded its LCC offering in 2000, and Japan in 2012). This segment is likely to continue to grow, and as existing and new destinations open up, we would expect visitation to follow suit.

Consumer confidence - Asian economies are mostly healthy. Consumer confidence is likely to strengthen gradually across the region, thereby boosting business and leisure travel. However, lack of hotel supply in some destinations (Tokyo), and too much in others (Singapore, Bali and Shanghai) is likely to temper growth.

Operator consolidation - we are in the cycle where, after a period of divestment, we are once again witnessing consolidation across the hotel industry. We have long held that once markets have matured and pipeline slows, the main way for hotel companies to realise value is through consolidation. We have already seen the Marriott and Starwood tie up, Accor and FRHI with the latter moving more towards strategic partnerships in boosting growth opportunities (Banyan Tree, Jo and Joe). In 2017, expect more vertical consolidation as hotels try to reduce the impact of OTAs.

Emerging markets - this represents the best opportunities for further brand penetration across the region and indeed for investors chasing yield. Political risk is being reduced in ASEAN countries, and with visa restrictions being eased, destinations in these areas are expected to continue to attract strong growth (Vietnam and Myanmar are examples).

Mid-market and lower segments - in mature destinations, we consider these segments to represent good value for money investment opportunities. In China, Taiwan, Hong Kong, Singapore and Japan, these represent growth segments given the low penetration of good quality internationally branded stock in these segments.

Technology - more and more technology is being seen as an alternative to lower costs and improved guest experience. Expect more of this in 2017 as smart technology continues to evolve. Existing platforms, especially marketing and booking engines are also likely to continue to improve particularly for mobile devices. Hoteliers will need to ensure they are not left behind and are at the forefront of search engines, especially as they gear up to drive the volume of direct bookings.

The return of value for loyalty - after a period where the value of being loyal was being eroded, expect programs to be revamped to foster instant recognition for loyalty members. This will include free Wi-Fi, discounted room upgrades, F&B discounts, and access to price match or lower rates than those being offered by OTAs.
**Day use** - it is being done at airports. Will hoteliers be brave enough to overcome the stigma and look at maximising their daily room yield?

**North East Asia Market Snapshots**

In this section, each quarter we will look at various selected destinations around the region in which we have recently worked to provide unique insights into hotel performance. The region includes destinations in China, Japan, Hong Kong, South Korea and Taiwan.

**Shanghai**

The Chinese hotel market has witnessed exponential growth in recent years and has rapidly evolved to become more sophisticated, especially as local owners secure investments in international operators.

Initially, growth was concentrated in the major mega-city locations such as Beijing, Shanghai and Guangzhou, which saw a proliferation of luxury hotels being built. Growth has now spread to key primary and secondary cities including Shenzhen and Chengdu, with focus turning to the international upscale and below segments as investment in the sector becomes more sophisticated, where we believe will offer good return on investment opportunities.

RevPAR in Shanghai has increased steadily despite the high number of room supply the city is expected to witness over the next five years. According to our research, Shanghai is expected to witness some 9,000 new rooms over the next five years, with over 23,000 in the pipeline, some of which is unlikely to eventuate.

This may well place some stress on hotel performance in the short to medium term, with the outlook for RevPAR subdued at circa 2.0% growth in 2017.

RevPAR has increased by a CAGR of 5.1% between 2012 and 2015, mainly underpinned by strong growth between 2013 and 2015, with new room supply increasing at relatively high levels during this period. RevPAR in Shanghai was CNY476 in 2015, versus CNY371 in 2011, an increase of 28.2% of over the period, mainly underpinned by an increase in ADR as the market attracted more domestic visitors and demand caught up with supply.

Visitation to the destination will depend on the economic outlook for China as it is one the country’s main industrial hub, and largest city. Shanghai is a major international business centre and one of the fastest growing visited destinations in the world, offering significant cultural and leisure activities.

In 2015, Shanghai welcomed 8.0m international overnight visitors, who spent 26.4m nights with an average length of stay 3.3 nights. Over 268m domestic visits were made, of which 65% overnight.
Tokyo

Japan has witnessed exponential growth in visitor arrivals since 2015 as the impact of LCC and easing of visa restrictions, together with the weak yen drove visitation in record numbers. Combined with the staycation effect, as it is more expensive for Japanese to travel overseas due to the weaker currency, hoteliers have enjoyed record room occupancies, with yield maximisation strategies focusing on ADR. This has led to a renewed interest in the hotel sector as an alternative asset class for investment, with new supply being ramped up in time for the Olympics in 2020. Regional Japan continues to be the most attractive with yields still relatively higher than that in Tokyo. In addition, the penetration of international brands in these areas remains low.

Tokyo will be the host city for the 2020 Summer Olympics. Given the relative similarities in the cities, we would expect visitation patterns to Tokyo, in the build-up and legacy, to follow that of London.

As such, whilst the outlook for tourism visitation to Tokyo remains cautiously optimistic, much will depend on wider economic issues, including currency movements, and infrastructure development including new hotel supply, together with operational restrictions including staffing shortages. Tokyo 2020 is the main development project in the city and indeed across regional Japan as there is an expectation of a strong ripple effect from the city to other destinations in terms of visitation. Narita’s expansion in 2015, to service low cost carriers and the future plan to expand Tokyo Disney and Haneda Airport are likely to continue to drive demand.

The potential of the future development of Integrated Resorts (IR) as part of an Olympic legacy could be a future significant demand generator for the city.

Tokyo is a major international finance centre and one of the most visited destinations in the world, offering significant cultural and leisure activities.

In 2015, the city attracted 11.8m overnight visitors, who stayed 67.8m nights. It is the 9th most visited destination globally by number of overnight visitors, and benefits from over 150m domestic trips, of which 65% resulted in overnight visitation.

RevPAR has grown by a CAGR of 10.6% between 2011 and 2015, mainly underpinned by the significant increase in visitation in 2015, with new room supply remaining at low levels during this period. RevPAR in Tokyo was JPY14,651 in 2015, versus JPY9,720 in 2011, an increase of 50.7% over the period.

We expect visitation to continue to increase over the next two years, albeit at lower rates of growth. Future performance is likely to be impacted by the hosting of the Olympics, and the legacy that it will leave behind. However, this may be mitigated by currency movements and the region remains sensitive to wider geo-political events.
South East Asia Market Snapshots

This region includes destinations in Singapore, Thailand, Vietnam, the Philippines, Myanmar, Malaysia, Laos and Cambodia.

Phuket

Despite continued political impasse, the recent death of the King and inauguration of a new, Thailand continues to demonstrate its remarkable ability to bounce back from events. Economic growth continues to be sluggish, but this is expected to improve as infrastructure projects eventuate, and the economy is reformed.

Phuket has witnessed exponential growth in tourist arrivals since the relaxing of visa rules and the increase in low cost carriers and destinations served since 2012. The destination’s increasing attractiveness, growing Chinese market, and medical tourism sectors have all contributed to this. In addition, there are an increasing number of direct flights from new destinations in Russia, the Middle East and China.

Phuket has good infrastructure with Phuket Airport recently adding a new international terminal. Since 2012, the destination has witnessed an increase in low cost carriers serving more destinations directly. Visitation to the destination will depend on the economic outlook for China and Russia, especially given the weakening of the rouble. Phuket is a major leisure destination and one of the fastest growing visited destinations in the world, offering significant cultural and leisure activities.

In 2015 it attracted 9.3m overnight visitors, who stayed 40.8m nights. It is one of the most visited destinations globally by number of overnight visitors and 6th within Asia Pac. The average length of stay is 4.4 nights.

RevPAR has decreased by a CAGR of 3.8% between 2012 and 2015, mainly due to the downturn in 2014, with new room supply increasing at relatively high levels during this period. RevPAR in Phuket was THB2,831 in 2015, versus THB3,345 in 2012, a decrease of 15.4% of over the period, mainly underpinned by a decrease in ADR as the market recovered, and the increase in supply at the lower end of the market, in addition to the targeting of more price sensitive Chinese travellers. YTD Oct 2016 RevPAR was up 7.0% on the corresponding period in 2015 which is mainly underpinned by strong growth in room occupancy, and demonstrates the resilience of this market. However, this growth is likely to be slightly tempered by the recent death of the King with the ban on entertainment and alcohol dampening tourism arrivals.

Source: Colliers International

We expect Phuket to continue to generate interest from international brands, especially in the upscale and below segments. The market is beginning to show some signs of de-coupling from Bangkok, and this will underpin investor confidence.
Phnom Penh

Cambodia remains an enigma even to the bravest of investors. Given the high political risk, foreign direct investment into the country has been relatively low especially in the hotel sector. However, a recent change in ownership laws and a move towards adopting transparency rules, especially against money laundering, has led to renewed interest. The country has always been seen as a stop-over leisure destination with little to see or do outside the main destinations of Siem Reap, Phnom Penh, and to a lesser degree Sihanoukville.

Given the low cost base and recent high and anticipated levels of foreign investment, economic growth is expected to be one of the highest in the short to medium term. However, looming government elections may temper any growth, albeit briefly.

Phnom Penh attracts some 4m visitors per year, most of whom either are there for leisure and business. The capital city is the most populated in Cambodia, and has a good international airport (a new domestic terminal is planned) and improving infrastructure. Confidence in the destination will be underpinned by the proposed Shangri-La, Okura and Hyatt Regency hotels as part of mixed-use developments, together with the increasing number of malls.

The city requires significant levels of infrastructure, and we expect that following a turbulent election period, investor confidence will return especially for those looking for yields. The expected passing of new legislation in regard to money laundering and gaming will likely spark renewed interest amount nervous investors, especially those with ties to the US and other regulated markets.

In 2015, the average length of stay as 3.75 nights, with a total of 15m nights, and is the 20th most visited destination in Asia Pac. The largest source markets are Vietnam, China, Thailand, South Korea and Laos.

RevPAR for Phnom Penh was estimated at US$103 at the end of 2015, representing strong growth on 2014, as the opening of Naga 2, had a positive influence on visitation. We believe as more high-end hotels enter the market, this will create some supply led demand, which in turn is likely to pull average room rates up over the medium term.

**Stage of investment cycle: Growth**

Yield expectation: 9.0% plus

9.0%
South Asia Market Snapshots

This region includes destinations in India, Nepal and Sri Lanka.

Colombo

Sri Lanka is recovering from a period of political impasse which had largely strangled the burgeoning tourism industry. Since 2010, the country’s economic growth and the level of foreign direct investment improved considerably. Much of the investment remains on much needed infrastructure, and improvements to the airport and roads in and around Colombo are likely to improve accessibility.

Tourism arrivals reached 1.8m in 2015, representing a strong 17.8% growth on the previous year. This reflects a continued upward trend, albeit from a low base since 2009. The country has a lot to offer as a tourist destination, whether it be cultural or nature. The largest source markets are India, China, the UK and Germany.

Colombo is the capital city and main entry point into Sri Lanka. The city continues to transform and much of the demand is expected to be supply led in the short to medium term. The city has previously lacked a significant presence of international brands, but with Shangri-La, Starwood and Movenpick expected to enter the market this will likely change.

Approximately 5,000 rooms are planned for the city over the next five years, with much of this positioned at the upscale or above level. This will be needed should the tourism marketing plan to attract more MICE and entertainment attractions eventuate.

RevPAR for hotels in Colombo decreased slightly in 2015, mainly as a result of a drop in ADR, with occupancy levels remaining strong, and in excess of 75% annually. As new supply enters the market, we would not expect too much of an impact on ADR given the city’s floor on room rates for hotels, and their anticipated market positioning.

As the city’s infrastructure and attractions improves, this is likely to underpin demand in the short to medium term. However, much will depend on the marketing ability of the tourism board in driving MICE to the destination, as corporate demand is likely to remain at low growth levels.

Colombo Hotels KPIs

<table>
<thead>
<tr>
<th>Year</th>
<th>ADR (US$)</th>
<th>RevPAR (US$)</th>
<th>Room occp (%)</th>
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<td>2016f</td>
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</table>

Source: Colliers Research

Stage of investment cycle: Growth

Yield expectation: 8.0% plus

8.0%
Destination of the quarter - Singapore

Tourism arrivals in Singapore are expected to grow in 2016 following a relatively stagnant performance in 2015. In 2016, visitor arrivals are expected to grow by circa 7%, reaching 16.2m, with a further 2% forecast for 2017. This is a robust performance after the stagnant figures in 2015, and is mostly underpinned by an increase in visitation from North Asia, and in particular China, despite the short term impact of the Zika travel warnings. This represents a compound annual growth rate (CAGR) of 3.6% between 2011 and 2016f. Over the period, the average length of stay at circa 3.5 days has remained relatively constant. However, total overnight stays (what really matters to hotels), only grew by a CAGR of 2.75%. This suggests that there is an increasing day tripping trend, and this is perhaps not surprising given the relative high costs of staying in hotels in Singapore (if you can find one!).

A closer look at the trends suggests that whilst visitation is up, average spends has remained relatively constant. Total tourism receipts in 2011 were S$22.3bn. In 2015, this had shrunk to S$21.8bn, a CAGR decrease of 0.45% for the period. This decline in spend is perhaps mostly reflected on the high streets where retailers are experiencing a drop. It also highlights the impact the change in foreign currency can have. Indonesia and Malaysia, which are two of the largest source markets to Singapore, have experienced significant declines in their currencies. This has resulted in an erosion of disposable income, and therefore a reduction in spending. As a result, tourism receipt per capita decreased from S$1,691 in 2011, to S$1,430 in 2015, a drop of 15.4%.

According to the Singapore Tourism Board (STB), circa 58% of overnight stays are in hotels, of which 47% of visitors are repeat guests. The main purpose of visit is leisure/VFR (over 57%), with circa 28% here on business/MICE visits. Considering these statistics, it suggests that Singapore still requires a significant amount of hotel rooms to accommodate its visitors, with growth in visitation being tempered by the low level of room supply especially at the mid-market to lower end. This is despite the significant increases in room supply in 2016 and that expected in 2017.

This is borne out in hotel performance which indicates that room occupancy remains well in excess of 85% despite the new supply. In any event, a closer look at the room stock versus demand, suggest that hotels in Singapore are full almost all the time during peak periods, and especially during Monday to Thursday, and Saturday nights. This suggests that there is a high degree of existing frustrated and latent demand, whereby visitors who wish to come to Singapore either cannot find rooms or have to turn to alternative accommodation providers (Airbnb anyone). From our analysis, in 2011, given that 57% of overnight visitors would stay in a hotel, based on the total number of available rooms at that time would give an implied room occupancy of 121%. From the hotel statistics provided by STB, which indicates that room occupancies for 2011 was 86%, this suggests only circa 40.5% of those requiring accommodation were able to do so in a hotel.

Fast forward to 2016, which suggests that hotel room occupancies will remain at circa 85% for the year, indicates that only 43% of the 57% requiring rooms would have been accommodated. We note that the implied room occupancy for 2016f would have dropped to 112%, given the increase in new supply. We expect this to further drop to 107% in 2017.

As such, in our opinion, it is not the supply side that is the main issue, but spend.

The decrease in tourism spend has impacted average room rates, which has dropped since 2013, as room occupancies have held up. In fact, in 2015, average room rates have remained unchanged at circa S$246, almost in line with that achieved in 2011. As such, whilst much has been made of the impact of new room supply on the market on overall hotel performance, it is perhaps more so the inability of hoteliers to push rates up that has tempered this. As such, despite the increase in room supply, we do not expect room occupancy rates to drop much lower, given the high level of existing frustrated demand. However, we would not expect ADR for hotels in Singapore to increase as long as the rupiah, ringgit and yuan remain relatively weak, or even weaken further. This, in combination with expected market entry discounting for new entrants, suggests a further weakening in RevPAR in 2017, by between 2%-3%, before perhaps recovering in 2018.
Key operational challenges for the Singapore hotel industry in the short to medium term is likely to remain on the staffing and service side, especially as locals continue to perceive the sector as one of low prestige, mainly due to lack of knowledge.

The sector remains inherently manpower driven, especially at the top end, and whilst technology will be able to mitigate some of the challenges, much will depend on the ability to attract good talent. As such, this may well place additional costs on hotels.
The Singapore hotel investment market

What can investors in the hotel sector expect in Singapore? In this section we briefly compare the average returns of Singapore hotels to that of hospitality REITS and other real estate asset classes over recent years.

As can be seen in the chart below, Singapore hotels, and especially hospitality REITs, have consistently outperformed other mainstream real estate assets. Between 2012 and 2016(f), hotels returned at an average of 5.9%, slightly lower than hospitality REITs at 6.6%, both of which were ahead of centrally located offices at 3.9%, retail at 5.0%, and long-leasehold industrial at 4.6%, with 10-year government bonds at 2.2% over the corresponding period.

Investment in hotels in the city state has only gathered pace from 2013 onwards, with this mostly being at the top end of the market. Previously, investment has been in the retail and office sector as the country rebalanced its economy. However, as demand has matured, and with supply peaking, the performance of these sectors has slowed placing pressure on rents and capital values especially in prime locations.

In Singapore, underpinned by strong demand and supply gaps, hotels remain good investments that can provide both income yield and capital appreciation in a destination which is dominated by the traditional real estate classes. However, the yield gap is closing or perhaps has even closed especially for hotel properties positioned at the top end of the market in prime locations.

We expect yields to widen in the short term as new supply is absorbed. However, this will be short-lived given the inherent scarcity in available sites for new hotel development. As such, should land prices continue to appreciate, it may be that attention will once more turn to acquisition rather new build.

In regard to Sentosa, investment on the island is likely to be tempered by the relatively short leases and owner/buyer price gap expectation. There has been significant new supply in this market, and as Genting’s performance peaks, much will depend on the destination to attract more MICE events. As such, the outlook for Sentosa remains cautiously optimistic.
Hotel Investment and Valuation

Valuation insights

With the increase in political risk, currency movements, and changes in consumer confidence, what is the value of your asset? An owner, may suggest that the value of his/her property has not changed, but when he/she says 'value', too often what is actually meant is worth. This is easily found when too often it is heard about 'bridging the gap between buyer and seller expectation'.

Also, when we speak of 'value' what does it mean? A market value is the value of an asset as at the valuation date, and hence it will inherently change depending on market sentiment and stage of the investment cycle at that time. As such, is enterprise value more relevant to long term decision making? This can be an important point to consider, especially for specialised assets with dynamic cash flows such as hotels.

After a strong 2015, which witnessed a number of high profile transactions including the InterContinental Hong Kong, transaction activity in 2016 was largely down. The continued dearth of transactions outside Japan and Australia, meant that the transaction market remained largely subdued throughout the year. In 2017, we consider this trend is likely to continue, as owners consolidate their portfolios and seek opportunistic investments as the bid-ask gap remains at historically high levels. Indeed, attention may continue to swing towards more acceptance of development risk.

The average price paid per room in 2016 was expected to be significantly down on the previous year, but the previous year's figure includes a number of trophy and mixed-use properties sold in Hong Kong and Japan. As such any comparable figure must be taken with caution as it very much depends on the quality and quantity of the assets being sold e.g. if there are more luxury hotel transactions in one period than say limited service, then the average will tend to be higher, and vice versa.

Perhaps more relevant is the consideration of yields, however, again these must be taken with caution as often transaction yields reflect that of mixed-use developments. According to our research, initial yields (cap rates) for hotels across Asia Pac have been compressing since 2011, after pushing upwards following the global financial crisis and the effect that had on the commercial real estate market.

Cap rates across markets, like hotel performance with its dynamic cash flows, will and can vary dramatically. The outlook for cap rates across the region in the short-term is widening, and much will depend on US Federal policy on interest rates, and the impact that will have on currencies, and capital flows. In addition, the economic outlook for key source markets could have an impact on profitability, which may lead to a widening of yields.

Cap rate outlook 2017

Short-term cap rate expectations for hotels across Asia Pac 2017

Source: Colliers International
With cap rates for luxury hotels remaining stubbornly low across markets, investors looking for yield more so than capital appreciation, will more and more consider investments in the upscale and lower segments. We consider that it is these segments that offer the best opportunities for growth in the short to medium term across Asia.

We believe investment in hotels as an alternative asset class is likely to continue, especially in those more established tourist markets where the yields are more attractive.

Traditionally, hotel yields are wider than that for the more mainstream real estate assets such as offices and retail. However, in recent times, especially as mixed-use buildings become the norm, with the diversification of risk and supply-led demand generators, these have compressed particularly in well-established destinations such as Toyo, Hong Kong and Singapore.

So where to invest in 2017? We would recommend a look at opportunities in the top 20 destinations in Asia according to the MasterCard Destinations Index 2016, which gives an indication as to where tourists to the region spend the most nights - a key indicator for hotel demand.

### Destination 2016 Total Overnight International (Millions) Arrivals Nights Expenditure (US$)

<table>
<thead>
<tr>
<th>Destination</th>
<th>Arrivals</th>
<th>Nights</th>
<th>Expenditure (US$)</th>
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<tbody>
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<td>21.5</td>
<td>104.9</td>
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<tr>
<td>Singapore</td>
<td>12.1</td>
<td>56.7</td>
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<td>Kuala Lumpur</td>
<td>12.0</td>
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<td>7.3</td>
<td>48.7</td>
<td>9,603</td>
</tr>
<tr>
<td>Pattaya</td>
<td>7.3</td>
<td>25.2</td>
<td>3,307</td>
</tr>
<tr>
<td>Osaka</td>
<td>7.0</td>
<td>25.7</td>
<td>3,395</td>
</tr>
<tr>
<td>Shanghai</td>
<td>6.1</td>
<td>20.2</td>
<td>4,998</td>
</tr>
<tr>
<td>Siem Reap</td>
<td>5.1</td>
<td>16.9</td>
<td>1,625</td>
</tr>
<tr>
<td>Mumbai</td>
<td>4.9</td>
<td>26.4</td>
<td>3,596</td>
</tr>
<tr>
<td>Hokkaido</td>
<td>4.8</td>
<td>25.4</td>
<td>2,860</td>
</tr>
<tr>
<td>Chennai</td>
<td>4.4</td>
<td>21.5</td>
<td>3,239</td>
</tr>
<tr>
<td>Beijing</td>
<td>4.1</td>
<td>17.3</td>
<td>4,082</td>
</tr>
<tr>
<td>Guangdong</td>
<td>3.9</td>
<td>9.5</td>
<td>1,774</td>
</tr>
<tr>
<td>Phnom Penh</td>
<td>3.9</td>
<td>14.6</td>
<td>1,405</td>
</tr>
<tr>
<td>Chiba</td>
<td>3.8</td>
<td>3.2</td>
<td>546</td>
</tr>
</tbody>
</table>

Source: MasterCard Asia-Pacific Destinations Index 2016

### Recent notable transactions

The continued investment into the asset class by institutional investors and the dearth of assets being sold, has meant that yields have and is expected to remain low, at least until interest rates increase significantly.

Across Asia, in 2016, the majority of transactions were in Japan, where the JREITS remain very active. The strategy there seems to be to diversify into regional Japanese destinations, increase their portfolio and rebrand in order to improve profitability and ultimately justify the low yields being paid to acquire properties.

Some of the notable transactions across the region includes:

<table>
<thead>
<tr>
<th>Hotel</th>
<th>Approx. value per room (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loisir Hotel Spa Tower Naha</td>
<td>292,359</td>
</tr>
<tr>
<td>Zitahli Kuda-Funafaru Resort &amp; Spa</td>
<td>620,000</td>
</tr>
<tr>
<td>Anantara Ubud</td>
<td>414,000</td>
</tr>
<tr>
<td>Grand Pujian Residence</td>
<td>734,167</td>
</tr>
<tr>
<td>Nam Hoi An</td>
<td>424,837</td>
</tr>
<tr>
<td>Urawa Royal Pines Hotel</td>
<td>814,286</td>
</tr>
<tr>
<td>Westin Resort Guam</td>
<td>289,352</td>
</tr>
<tr>
<td>Grand Pacific Le Daiba</td>
<td>684,050</td>
</tr>
<tr>
<td>Grand Hi Lai</td>
<td>436,009</td>
</tr>
<tr>
<td>Hotel Grand Pacific Meridian</td>
<td>680,541</td>
</tr>
<tr>
<td>Hotel Sunroute Shinagawa Eastside</td>
<td>149,531</td>
</tr>
<tr>
<td>Somerset Zhong Guan Cun Beijing</td>
<td>600,649</td>
</tr>
<tr>
<td>InterContinental Asiana Saigon</td>
<td>245,574</td>
</tr>
<tr>
<td>Hotel Vista Grande Osaka</td>
<td>880,446</td>
</tr>
<tr>
<td>Hotel Mystays Gotanda Station</td>
<td>708,873</td>
</tr>
<tr>
<td>Hotel Epinard Nasu</td>
<td>675,222</td>
</tr>
<tr>
<td>Hilton Nagoya</td>
<td>329,811</td>
</tr>
<tr>
<td>Renaissance KL</td>
<td>203,474</td>
</tr>
<tr>
<td>Duxton Hotel Saigon</td>
<td>249,222</td>
</tr>
<tr>
<td>Sedona Suites Hanoi</td>
<td>180,000</td>
</tr>
<tr>
<td>Aloft Kuala Lumpur Sentral</td>
<td>213,610</td>
</tr>
<tr>
<td>Swissotel Nai Lert Park</td>
<td>542,154</td>
</tr>
<tr>
<td>Amaya Kudarah Maldives</td>
<td>450,980</td>
</tr>
<tr>
<td>A3 Hotel Temple Street</td>
<td>309,400</td>
</tr>
</tbody>
</table>

Source: Colliers Research Note: US$ conversions are at time of transaction and represents approx. values.
Colliers Hotels Valuations Service

Colliers has a rich valuation experience on multi market portfolios across Asia Pacific. We undertake over 250 hospitality valuations each year, including single assets and portfolios for reporting, financing and transaction advisory purposes. Our experience ranges from budget properties to ‘trophy’ assets, many of which also include mixed-use components.

We are engaged by clients to undertake annual valuations for properties for reporting purposes on a rolling basis for a number of years, with some relationships still ongoing. This therefore provides us with an intimate, and readily available platform for local, and recent relevant market knowledge which will enable us to perform the valuations effectively.

The valuation team is supported by our Research and Advisory team within the local markets. The Research and Advisory team works closely with our business service professionals, capitalising on our market expertise to provide our clients with the necessary market intelligence across all markets – ranging from data collection to comprehensive market analysis, interpretation and recommendations – required to support sound and practical business decisions.

Our market insight and knowledge are our clients’ property, pivotal in accelerating their success. The overall hospitality team is part of one of the largest in Asia Pacific that performs in excess of 250 valuations per year in the sector, and contains professionals dedicated solely to hotels, leisure and hospitality valuation work, and includes a number of published authors in the field.
Gaming

High stakes for gaming across Asia

To say the cards were on the table for gaming destinations across Asia Pacific in 2015 is perhaps an understatement. However, whilst VIP revenues have continued to witness a significant drop, especially in Macau, mass market play continues to gain ground, with 2016 gross gaming revenues expected to drop by only 3.5% for the year.

The clampdown on conspicuous spending and money laundering in Mainland China had led to a 34.3% decrease in gross gaming revenues (GGR) in Macau alone in 2015, with the VIP/junket segment being decimated. The big winner of this appears to be mainly Cambodia that has largely benefitted from the fallout in Macau, with NagaCorp, Cambodia’s largest casino in Phnom Penh, witnessing a 22% increase in profit for 2015, when compared to the previous year. The latest financial results for 2016 (Interim) shows that Naga2 continues to drive demand, however the decision to lower junket commission rates has halted growth in the VIP segment, with EBITDA expected to grow by circa 14% year on year. As such, we expect more and more established casinos to focus more on the more lucrative mass gaming market.

Asian gaming has and continues to shift rapidly to new norms. Previous levels of frustrated and latent demand are being quickly absorbed as new supply enters the market, and as governments across Asia realize they are leaving money on the table (or giving it away in some cases) by not penetrating the gaming market, regulating and taxing it at the right levels. This, combined with slowing growth in demand, has meant that investors are no longer witnessing the eye watering returns as with previous investments and must be more discerning. The reality is that the game is changing.

The slowdown in the size of the Chinese and wider Asian gaming market was inevitable. Gaming is largely a discretionary leisure spend, and as such will be subject to cyclical events, and changes in consumer behaviour and confidence. We expect the new norm for Asian gaming to be on the idea of integrated resorts (IR) in one form or another, as this is seen as the most politically acceptable and diversified offering that can have a wider appeal. However, the region is not a one size fits all scenario and one must consider each market individually.

In our estimation, the size of the Asian gaming market, which is directly correlated with GDP growth in Asian source markets (0.91 correlation factor over the last five years), is likely to slow in the short to medium term. We estimate that after a period when there was significant latent demand for gaming in the region, supply has now caught up, and the sector is relatively mature. As such, any new supply will have to be competitive and offer a unique product that can capture demand from other established destinations in the short to medium term.

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We expect total gross gaming revenues to be circa US$82.1bn in 2016, following a slowdown in 2015, as new properties in Macau establish themselves. We expect gaming revenues to improve from 2017 onwards in line with anticipated GDP growth for the key source markets in the region. Over time, with is likely to lead to additional levels of latent demand as new supply takes time to enter the market.

The recent announcement that Japan will be legalising gaming is unlikely to cause short term disruption at the operational level, but it may well impact decision making. We explore this further in the following section.

We believe South Korea, with the large number of integrated resorts (IR) planned, could be in danger of oversupply, and in the longer term, may be exposed especially if more casinos are not allowed to offer gambling to locals. The Philippines has its inherent problems, and is very much expected to remain a mass market destination for locals. Recent press articles suggest that Vietnam is set to announce at least four
multi-billion dollar IR, however, one would question the feasibility of this even if locals are allowed to gamble (it has recently been announced that two properties will be allowed to accept locals for gambling). This is especially with the increase in supply across the region, and as neighbouring Cambodia is expected to develop its own IR model, in anticipation of Vietnam legalizing locals gambling, which would significantly impact its border casinos. We believe that the true local target market for casinos in Vietnam is much smaller than anticipated at around 9 million.

A close look remains on legislation improvements in Cambodia, India, and Sri Lanka, with Nepal clearly benefiting from the proximity of the latter two markets and their restriction on gambling at the moment. Cambodia with its low cost base and improved regulation could well offer good IR potential, especially along its south coast. However, we would not recommend more than one large IR. However, much will depend on how Cambodia approaches the issue of tax, with a tax on GGR highly recommended as this is likely to be the least subjective, and can be easily audited.

Gaming is a key driver for international visitation in the region, and if done correctly can add value to local economies, whether it be from income tax contributions, or job creation, and the multiplier effect that can have. As such, the feasibility and economic impact of new developments must be fully assessed. Governments are expected to look towards gaming to realize much needed income tax (even Cambodia, is finally considering the introduction of a structured gaming tax), and as supply catches up with demand, properties in lower cost destinations are expected to be attractive given the higher potential returns ie given the right infrastructure and legislation are in place.

Valuations

We expect valuations of existing properties to stabilise or fall slightly across the sector, especially as the non-renewal risks of concessions in Macau rise, and the potential for cannibalisation increases as new IRs open in the short to medium term. This is despite the rebalancing of revenue sources to more non-gaming activities. We expect the more mature destinations such as Singapore, and the older more established Macau destinations, to continue to do relatively well, albeit at a new normal.

According to analysts’ reports, currently, the valuation of the six large casinos in Macau range from 8.2 times (SJM) to 18.3 times (Sands and Wynn). We consider this slightly high given the slowdown in demand growth, supply side risks, and significant capital requirements that will be needed for new investments. In addition, even in the heady days before 2014, valuation multiples were not as high, and we do not believe non-renewal risks are priced in, with the consensus being all existing operators will be granted extensions. But as recent activity has shown, nothing is certain anymore. Further, it is likely that the increase in the provision of non-gaming activities, may in the short term have an impact on overall profitability as these offerings establish themselves in the marketplace, thus impacting yields.

Gaming in Japan - the new El Dorado?

Whilst there has been much talk about Japan, the first step towards realising this was only recently announced in late 2016, with the Japanese government passing the first bill towards legalising gambling in the country in December 2016.

It is expected, and quite rightly in our opinion, that no more than three to four IRs (possibly two large and two smaller satellite properties) are allowed as part of the legacy following the Olympic Games. Construction costs in Japan are currently prohibitively high given the work being done in preparation for Tokyo 2020, and in any event it would be extremely difficult to secure contractors.

We expect, despite most expectations, that investment here will be largely locally driven, with the highest potential for the involvement of international companies being through either a joint venture or management agreement.

Investment in the sector in Japan is likely to be significantly expensive and our recommendation would be for potential investors to work with the Japanese government to secure Olympic sites that can be readily converted. This will potentially drastically reduce construction costs.
We expect the Japanese gaming regulation model including taxing, to follow that of Singapore, albeit with a few tweaks especially in regard to VIP gaming and allowing of locals to gamble.

We anticipate by 2020, when the first IR construction may begin, the potential gross gaming revenues in Japan would be circa US$20bn. This places it second behind Macau and higher than Las Vegas. The key source markets, apart from domestic, are likely to be mostly North Asia, which may well impact properties in Vladivostok, South Korea and even Macau, especially in the early years of operation as the novelty effect takes hold.

**Japan IR target market**

![4-hr flight time radius](source: Google Maps)

The high level of investment required combined with higher operating costs, and challenges to be faced, especially in regard to labour, is likely to extend the payback periods for investments in Japan. As such, anyone expecting a Macau or Singapore level of return would perhaps be disappointed.

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**In our next quarterly digest**

**Opinion** - Return on investment for luxury hotels  
**Opinion** - High-end restaurants and hotels  
**Leisure** - The demand for thrills - Theme parks in Asia  
**Hotels** - Destination of the quarter - Guam  
**Technical** - Revenue Recognition - IFRS 15 update
Technical and Opinion

In this section we briefly look at relevant operational, recent accounting and technical issues that is likely to have an impact on the hospitality and leisure sectors. We also provide topical opinion articles.

Are you spending your marketing money wisely

Visitation and overnight stay across Asia is mostly driven by intra-regional travel with China accounting for the largest share of outbound travel in 2016f. According the MasterCard Asia Pacific Destinations Index Report 2016, collectively, the top 10 source markets are expected to make up circa 76.8% of total overnight arrivals in 2016.

Demonstrating the importance of the regional market, of the key source markets for Asia only three countries outside the area were in the top 10: USA, UK and Australia.

Further, in certain destinations, the size of the domestic market should not be underestimated. China, Japan, Hong Kong and South Korea have sizeable domestic markets, but interestingly there is little marketing efforts here. The approach to the domestic market tends to be more sales driven through local corporate contracts. In countries where the currency is relatively weak, we expect an increase in the so-called ‘staycation’ effect. Indeed, we are already witnessing this in Japan, Malaysia and Indonesia.

Marketing remains a key function of a hotel’s operation and it is vital that properties can respond to change in market trends especially in driving rooms and other operating departments yield. Without a targeted approach the marketing budget can be easily wasted with little or no return on investment. As such, it is vital that marketing executives have a clear strategy for growing market share and therefore a hotel’s revenue generation index.

How one markets a property very much depends on its stage of growth. If it is a new hotel, then the marketing strategy will need to be aggressive and start well in advance of the hotel’s opening. In the growth phase getting to break-even occupancy must be the priority whilst achieving the ‘right’ average room rate. Pricing rooms at such an early stage will need to be strategic to allow for a quick ramp-up, but enough room for which to increase rates going forward. Set too low, and the ability to drive rate increases through in the future will be met with resistance; set too high, occupancy will suffer. As such, in preparing the sales and marketing plan, executives must know their market and key targets. In addition, any plan should take into account the lag between first contact and room booking, which can be up to a year or more for contract corporate and MICE bookings for example.

Being visible online and optimising search results for the hotel is key in the early stages of growth.

As the property matures, and it achieves room occupancy of say 72% or more, yield maximisation strategy must turn to driving room rates. It is at this point that the hotel can drive efficiencies true and maximise profits. Remember, rooms are the most profitable part of the hotel’s operations, and with a high level of fixed costs (circa 75% of department costs are fixed), the ability to achieve incremental profit is strong.

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Top 20 source markets for Asia - 2016f

1. Australia
2. Indonesia
3. China
4. Germany
5. Japan
6. France
7. Malaysia
8. Russia
9. Singapore
10. India
11. South Korea
12. Canada
13. Taiwan
14. Hong Kong
15. Thailand
16. Vietnam
17. UK
18. Philippines
19. USA
20. New Zealand

Source: MasterCard Asia Pacific Destinations Index 2016
At this point marketing activities must turn to higher yielding business e.g. upselling higher spending accounts, its suites product and focusing on capturing the top 1% of business from other properties. It is here that hotels can improve their revenue generation index.

**Accounting for leases - IFRS 16 update**

In this quarter, we focus on the recent requirement under IFRS 16 which all entities reporting under these standards are required to adopt for accounting periods on or after 1 January 2019, with early preparation recommended.

IFRS 16 mostly impacts lessees, which requires the recognition of assets and liabilities for most leases, regardless of industry. The introduction of this standard is likely to impact balance sheets, with gearing, covenant and interest cover ratios being impacted.

For lessees the existing provisions under IAS 17 remains, with little change.

For hotel owners and lessees, the impact will be high, with the only exemptions potentially being short leases (less than 12 months) and low value assets. All other leases, whether equipment hire, ground or sub-leases, will fall under the new standard. Previously, these may have been treated as operating leases, with the payment charged to the P&L. The new standard requires that an asset is recognised which is derived from its right of use, and a corresponding obligation to make lease payments over the term of the agreement.

The asset is to be initially measured at the amount of the lease liability, adjusted for any prepayments, incentives received, direct costs, and an estimate of restoration, removal and dismantling costs. The asset is then depreciated, and subject to impairment tests.

The lease liability is the present value of the lease payments to be made over the lease term. Interest is reflected as finance costs in the P&L, with payments reducing the liability.

In addition, there are changes in how sale and leaseback transactions are seen.

In our opinion, the introduction of this standard is likely to further dampen the willingness to take on leases and even some hybrids in the hotel sector by operators. As such, hotel management agreements will continue to be the desired route for operators, and owners will need to adopt to this structure across the region.

**Disclaimer**

All opinions in this digest represent general rather than specific views of the author. It should not be relied upon for making investments decisions nor assessing specific views of the author. The author nor Colliers International do not accept any liability for any decision made based on this digest.
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Colliers professionals think differently, share great ideas and offer thoughtful and innovative advice that help clients accelerate their success. Colliers has been ranked among the top 100 global outsourcing firms by the International Association of Outsourcing Professionals for 12 consecutive years, more than any other real estate services firm.

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