

Post COVID-19 Hotels in Asia Pacific

September 2022

IN A NUTSHELL

- Increasing outbound tourists from developing Asian countries, especially from China, should continue to lead the growth in nearby tourism destinations over the next decade.
 - Due to stricter border controls, the hotel recovery in Asia Pacific is lagging US or Europe, providing a window of opportunity for long-term investors.
 - With high tourism industry competitiveness, Japan key metros are best positioned for post-COVID-19 recovery, followed by Australia, South Korea and Singapore.
 - With decent ADRs, higher operating profit and lower operational risks, limited-service hotels should provide higher profitability and stable cash flow to investors.
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Despite the intermittent resurgence of COVID-19 infections, concerns over coronavirus appear to have waned worldwide since the start of 2022, enabling a strong rebound of international tourism and cross-border business travel. According to UNWTO, international tourist arrivals worldwide during the first five months of 2022 recovered to almost half of pre-pandemic 2019 levels, led by strong recoveries in Europe and the Americas (60% of 2019 levels), propelling hotel ADRs in key markets above pre-pandemic levels, and to record highs. In stark contrast, international tourist arrivals in Asia Pacific remain at only 10% of 2019 levels with ongoing strict border controls in some countries restricting non-essential travel and resulting in the underperformance of APAC hotels compared to their global peers. This deferred recovery of hotel markets in APAC could however provide an attractive investment window for sophisticated hotel investors, particularly as the rapid increase of middle-income population in developing Asian should support strong hotel demand growth over the next decade.

This report aims to provide a current snapshot of APAC hotels and the future recovery path, helping investors get the comprehensive view of the sector in the key markets of Japan, Australia, South Korea and Singapore.

Looking back at the tourism industry in Asia Pacific region in pre-COVID era, the total number of overseas tourist arrivals in the four key APAC countries grew rapidly by around 2.3 times between 2010 and 2019. Among them, Japan saw the most rapid growth of almost 4 times between 2010 and 2019, while South Korea, Australia and Singapore also saw growth of 60-100% in the same period. Behind their success, outbound Chinese travelers have been the largest tourist group by nationality in all these markets, and the strongest driver with an additional 10-20 million travelers every year. The biggest reason behind their high correlation is their proximity to major Chinese cities. These countries are located within a 3-to-5-hour flight radius, providing accessibility, convenience, and cost efficiency to Chinese tourists. In addition, the limited number of vacation days available to Chinese workers also favors shorter flights as top destinations for outbound Chinese tourists.

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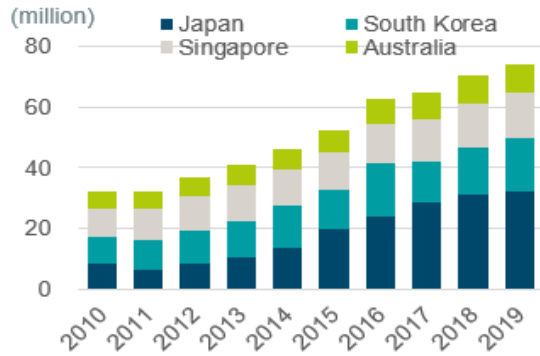
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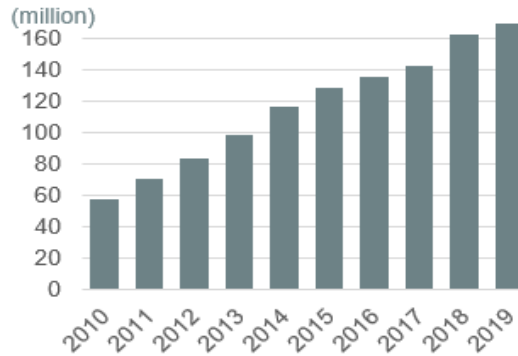
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EXHIBIT 1: OVERSEAS TOURIST ARRIVALS IN ASIA PACIFIC

OVERSEAS TOURIST ARRIVALS BY SELECT COUNTRY IN ASIA PACIFIC REGION (2010-2019)



NUMBER OF MAINLAND CHINESE OUTBOUND TOURIST (2010-2019)

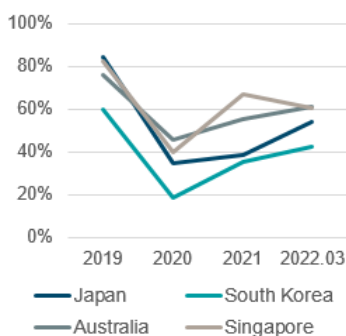


Source: DWS, UNWTO. As of September 2022.

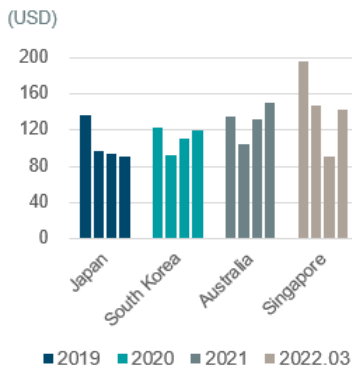
However, the tide changed suddenly with the pandemic. Since March 2020, the number of overseas tourist arrivals across the region recorded a sharp decline to almost zero throughout 2020, dragging down hotel occupancies to historical lows of around 20-40%. Hotel occupancy rates in these markets saw some recovery with the easing of domestic travel from 2021, strengthening further in 2022. However, by March 2022 RevPAR remained subdued at around 50-60% of 2019 levels with continuing strict border controls. Compared to the US and Europe, overseas travelers in Asia Pacific region still face multiple challenges including high travel expenses, extra visa requirements and additional quarantine risks. Despite recent easing for border controls, it might take another 6-12 months or even longer before the full normalization of cross-border travel in these countries.

EXHIBIT 2: HOTEL PERFORMANCES IN KEY APAC MARKETS

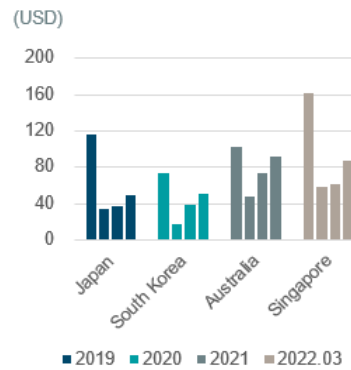
HOTEL OCCUPANCY RATES



ADR (USD)



REVPAR (USD)



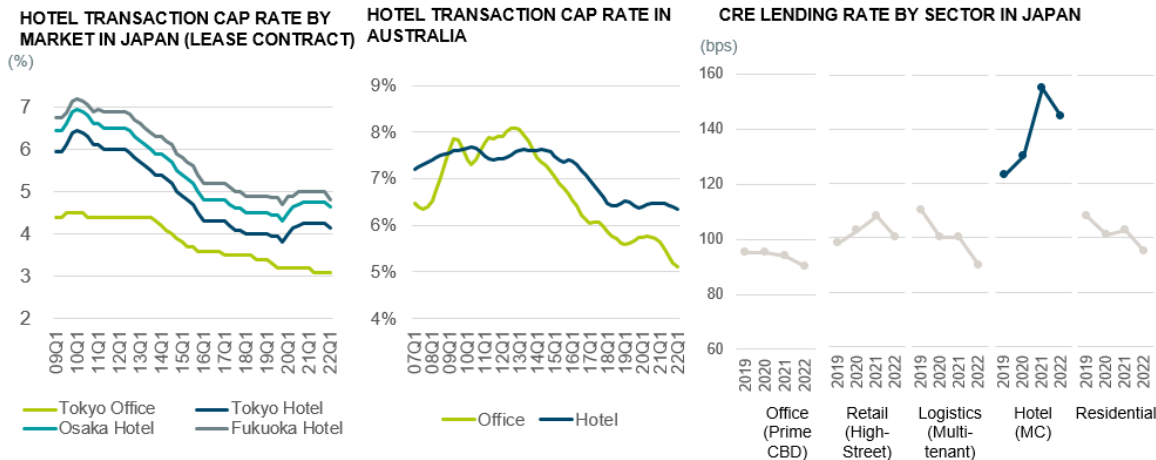
Source: STR, CBRE, DWS. As of September 2022.

Impacted by this sluggish performances, hotel transactions in Asia Pacific have also weakened considerably. Hotel transaction yields in Japan have widened by 30-50 basis points, expanding the yield spread between office and hotel from 50 bps to 100 bps in the last 3 years. Similarly, the yield spread between office and hotel in Australia has widened from 80 bps to 130 bps in the last 3 years, although more driven by office cap rate compression. The lending environment also deteriorated as borrowing cost increased to c. 160 bps in Japan, with some lenders halting all lending to the hotel sector. Entering 2022, the situation has improved with many lenders

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reconsidering credit financing to the hotel sector, though selectively and depending on brand, location, operator credibility, seasonality, lease type etc.

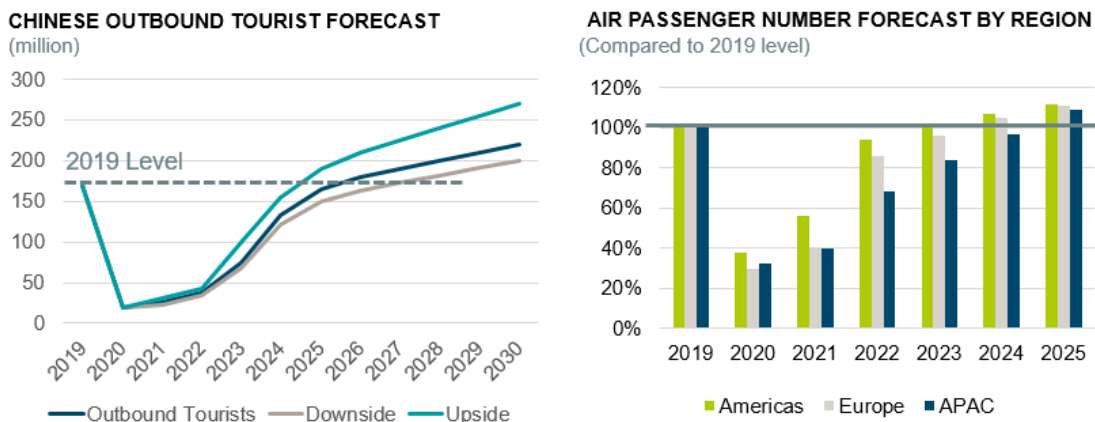
EXHIBIT 3: HOTEL TRANSACTION CAP RATE AND LENDING RATE IN JAPAN



Source: RCA, CBRE, DWS. As of July 2022.

Globally, the recovery in air passenger traffic is underway, although Asia Pacific is lagging significantly behind the US and Europe primarily due to ongoing China’s strict border controls. By sticking to its zero-COVID policy, China continues to keep its borders largely closed, limiting outbound tourism in the near term, at least until early 2023. But in the longer-term, the prospects for outbound travelers from China and developing Asian countries are generally promising. Though the full recovery to 2019 levels is only expected by 2026, it represents a robust increase in outbound travel demand to neighboring destinations like Japan, South Korea, Singapore, and Australia. Owing to their proximity, these markets will likely receive the majority of demand, as travel preferences among Chinese travelers do not show signs of an immediate shift towards new markets outside Asia Pacific region.

EXHIBIT 4: FORECAST OF CHINESE TOURIST AND APAC AIR PASSENGER



Source: Oxford Economics, IATA, DWS. As of September 2022.

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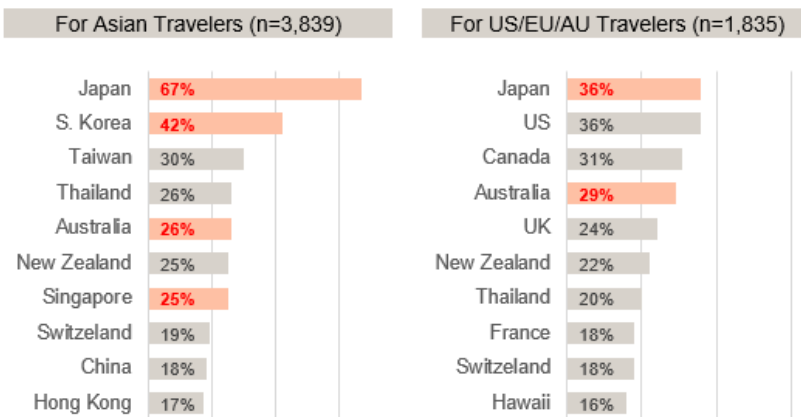
Moreover, proximity is not the only virtue of these four markets to attract outbound travelers. Japan topped the tourism and travel development index issued by World Economic Forum in 2021, while Australia, Singapore and South Korea also ranked highly in global top 15, proving their high competitiveness as a primary choice for outbound travelers not only from developing Asian countries but also travelers worldwide given tourism infrastructure, cultural and natural resources. Likewise, according to a recent survey targeting international tourists in 2021, Japan was the top choice of Asian tourists and the second most popular among respondents in western countries. South Korea, Australia and Singapore were also included in top 7 destinations among Asian travelers.

EXHIBIT 5: TRAVEL & TOURISM COMPETITIVENESS OF APAC COUNTRIES

WEF TRAVEL & TOURISM DEVELOPMENT INDEX (2021)

Rank	Country	Region
1	Japan	APAC
2	United States	America
3	Spain	Europe
4	France	Europe
5	Germany	Europe
6	Switzerland	Europe
7	Australia	APAC
8	United Kingdom	Europe
9	Singapore	APAC
10	Italy	Europe
14	Netherlands	Europe
15	South Korea	APAC
16	Portugal	Europe

DBJ/JTBF SURVEY FOR NEXT COUNTRY TO TRAVEL (2021, N=5,692 TRAVELERS, MAX. 5 COUNTRIES)



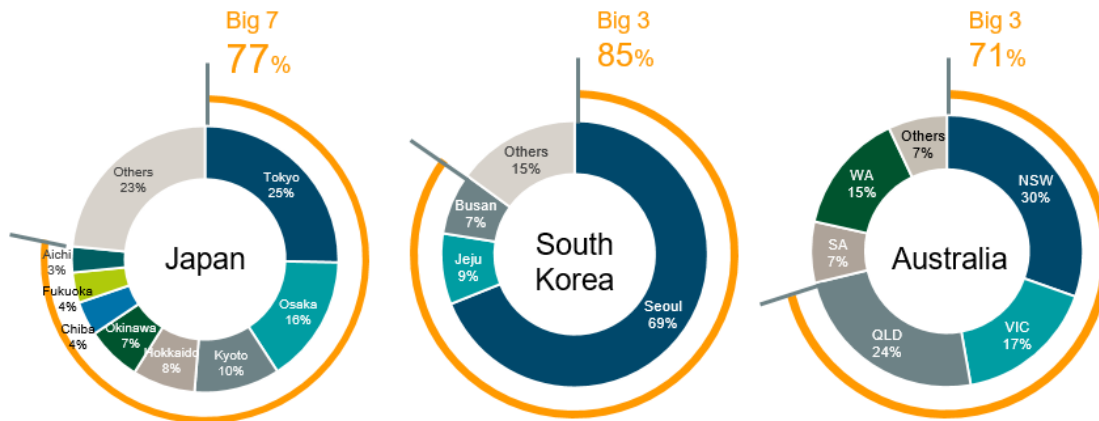
Source: DWS, World Economic Forum "Travel & Tourism Development Index 2021", DBJ/JTBF Survey, As of September 2022.

It is also noteworthy that overseas tourist stays tend to concentrate in a few key destinations with superior access to international airports. In Japan, the top 7 destinations include Tokyo, Osaka, Kyoto, Fukuoka and Sapporo, accounting for 77% of overnight stays by overseas tourists. In South Korea, Seoul accounted for 69% of overnight stay by overseas travelers showing the high concentration of travel demand in the country, while Busan and Jeju are increasingly serving overseas tourists these days. In Australia, the top 3 states of New South Wales, Victoria, and Queensland serve as major destinations accounting for 71% of overseas tourist arrivals to Australia.

In assessing the potential demand growth in post-COVID era, the past performances of Japanese regional cities serving overseas tourists were more than impressive in that they saw around 3-7 times growth of overseas tourist arrival in just 10 years between 2010 and 2019. With the recent rapid depreciation of Japanese Yen, the attractiveness of these cities to overseas tourists should increase further once the international travel regulation is lifted in the country.

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EXHIBIT 6: OVERNIGHT STAY OF OVERSEAS TOURIST BY REGION IN APAC COUNTRIES (2019)

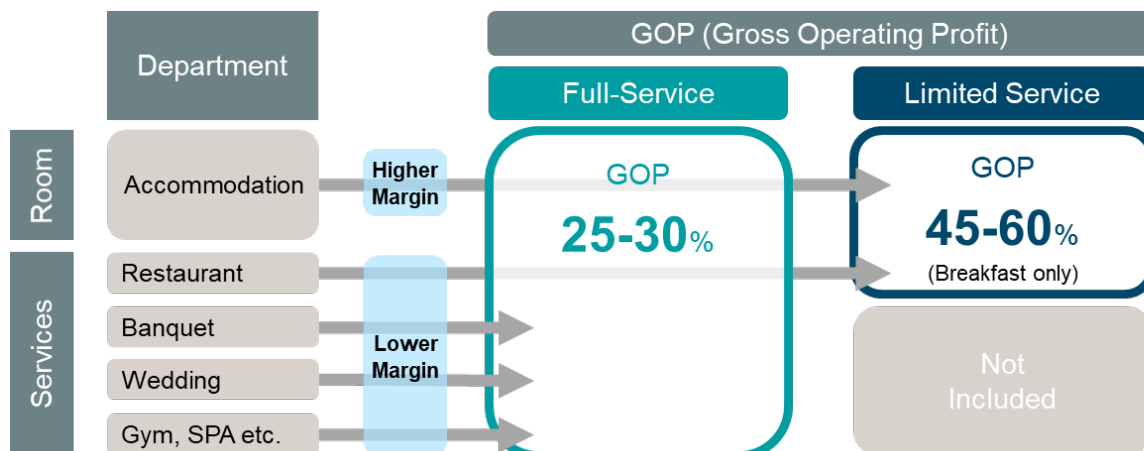


Source: Japan Tourism Agency, Korea Hotel Association DWS. As of September 2022.

In terms of profitability of investible grade hotels by type, it is interesting that limited-service hotels are usually more lucrative than full-service hotel due to their stable cashflow and low operational risk. As shown in the chart 7, the limited-service hotels provide only accommodation and breakfast to visitors, which let them focus on higher margin services. On the other hand, full-service hotels are required to provide various services accompanying heavy labor costs, inventory losses and unstable reservations, resulting in lower profitability and higher cash flow volatility compared to limited-service hotels. It becomes more obvious when we see that limited-service hotel accounts for 71% of securitized hotel assets owned by Japan REITs.

From the future demand perspective, the upscale limited-service hotels are expected to see the strongest demand growth, especially in Japan, driven by middle-income outbound tourists from developing countries who are cost-sensitive but prefer higher quality accommodation than economy grade at the same time.

EXHIBIT 7: HOTEL GOP RATIO BY GRADE IN JAPAN (PRE-COVID19)



Source: DWS. As of September 2022.

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Investment strategy

Considering the anticipated recovery of hotel performances, the hospitality sector in Asia Pacific region provides a window of opportunity for investors in the short-term, further underpinned by the long-term demand growth from growing middle-income population.

Among key APAC countries, Japan could become the biggest beneficiary of the post COVID travel demand recovery in the long-term, with its highest level of travel and tourism competitiveness in the world and proximity to the fast-growing developing countries in Asia.

By segment, the upscale limited hotel could be highly sought after by investors given the increasing demand for upscale accommodation from travelers and higher profitability levels. Key Japanese markets including Tokyo, Osaka, Kyoto, Fukuoka, and Sapporo are well positioned to absorb most of inbound tourist arrivals to the country with their strong travel competitiveness and infrastructure level, well proven in the previous decade before the COVID-19 outbreak.

Turning attention to the other countries, investment opportunities also look attractive with potential pricing discounts in the short-term, yet underpinned by long-term travel demand growth. However, the opportunities to find proper structuring and investible size assets are rather limited to Japan. Nonetheless, well-located investment-grade hotels secured by a master-lease contract to a strong hotel operator provide a strong potential for attractive risk-adjusted returns. Given the narrower market depth, target markets are concentrated on key tourist cities in Australia, South Korea, and Singapore.

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