The HVS International

Journal

April 2002

Asian Hotel Valuation Index 2001

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Every year, HVS International Singapore estimates the hotel values of five-star hotels located in capital cities and resort destinations across Asia using its sophisticated benchmark study, the Hotel Valuation Index (HVI). Operating data for each hotel within a representative sample of hotels selected for each market is aggregated to produce an average performance for the city as a whole. This is used to derive a representative forecast of income and expense for each market, which reflects demand and supply conditions prevailing over the year. A unique discounted cashflow valuation technique developed by HVS International is then applied, using the prevailing market rates of return for each city. In order to make a direct comparison from year to year possible, the sample for each city has remained the same.

Despite high expectations and promising results during the first half of 2001, the 11 September terrorist attacks in the United States and the subsequent softening of economies around the world affected the outlook of five-star hotel markets throughout Asia. The *HVI 2001* shows that on average, hotel values across Asia declined by approximately 5% compared to an increase of 7% in 2000 and 4% in 1999.

Generally, markets depending largely on American and European demand, both commercial and leisure, are likely to be affected more severely than markets that rely more on regional demand.

Table 1 Hotel Values per Room 1998-01 (US$)

	1998	1999	% Change	2000	% Change	2001	% Change
Bangkok	150,000	154,000	3%	167,000	8%	173,000	3%
Beijing	166,000	140,000	-19%	147,000	5%	151,000	3%
Shanghai	202,000	177,000	-14%	196,000	10%	201,000	2%
Kuala Lumpur	74,000	75,000	1%	92,000	18%	90,000	-2%
Phuket	176,000	202,000	13%	220,000	8%	214,000	-3%
Bali [1]	135,000	141,000	4%	161,000	12%	156,000	-3%
Average	215,000	223,000	4%	240,000	7%	229,000	-5%
Tokyo	633,000	683,000	7%	697,000	2%	665,000	-5%
Seoul	259,000	310,000	16%	326,000	5%	308,000	-6%
Jakarta	70,000	70,000	0%	79,000	11%	74,000	-7%
Hong Kong [1]	383,000	398,000	4%	477,000	17%	441,000	-8%
Taipei	173,000	182,000	5%	184,000	1%	170,000	-8%
Singapore [1]	244,000	256,000	5%	281,000	9%	256,000	-10%
Manila	127,000	116,000	-9%	97,000	-20%	84,000	-15%

Note: [1] Different Sample in 2001

Source: HVS International Research, 2002

Furthermore, markets that recovered more quickly from the 1997 financial crisis are also more likely to be affected by current events than cities that only experienced a marginal recovery from the Asian crisis, e.g. Kuala Lumpur, Bangkok and Jakarta. With increasing regional uncertainty in the wake of the 11 September events, potential hotel investors, lenders and developers are maintaining a “wait and see” attitude. As the gap between market values and development costs widens, development opportunities across the region will remain difficult to justify. Furthermore, as many hotel owners expect this downturn to be short-lived, like the 1997 currency crisis, many will continue to hold on to their assets. This is highlighted by the fact that very few hotel transactions were concluded in the market in 2001.

With the economies of Asia’s main trading partners, the US and Japan, sluggish, the region’s five-star hotel market outlook has deteriorated. This has been worsened by the rising concern regarding Asia’s ability to successfully tackle the growing terrorist threats across the continent. As such, hotel cashflows remain under pressure; thereby increasing investors’ return requirements and cost of debt.

With corporate travel decreasing in volume and international meetings and conventions being cancelled in response to the global economic downturn, five-star hotels throughout Asia experienced a decline in corporate demand in 2001, particularly in the aftermath of 11 September. Furthermore, with the perception of Asia negatively affected following the terrorist attacks in the US, leisure demand accommodated by five-star hotels in the region also declined. Consequently, occupancy and in many instances, average room rates of five-star hotels in Asia dropped during the second half of 2001, thereby affecting the full-year room revenue of hotels. At the same time, hotel cashflows were further affected as demand for other hotel services, such as restaurants, meeting facilities and so forth also decreased in line with the decline in room demand.

However, with a global economic recovery anticipated in 2002, provided the war against terrorism stabilises, and with many Asian economies being boosted with stimulus packages, the regional outlook is not entirely negative. As such, we consider that hotel values are likely to bounce back in the short to medium term instead of declining further, as experienced by the market after the 1997 currency crisis.

Table 2 Hotel Valuation Index 1998-01

	1998	1999	2000	2001
Tokyo	294	318	324	309
Hong Kong	178	185	222	205
Seoul	120	144	152	143
Singapore	113	119	131	119
Average	100	104	112	107
Phuket	82	94	102	100
Shanghai	94	82	91	93
Bangkok	70	72	78	80
Taipei	80	85	86	79
Bali	63	66	75	73
Beijing	77	65	68	70
Kuala Lumpur	34	35	43	42
Manila	59	54	45	39
Jakarta	33	33	37	34

Source: HVS International Research, 2002

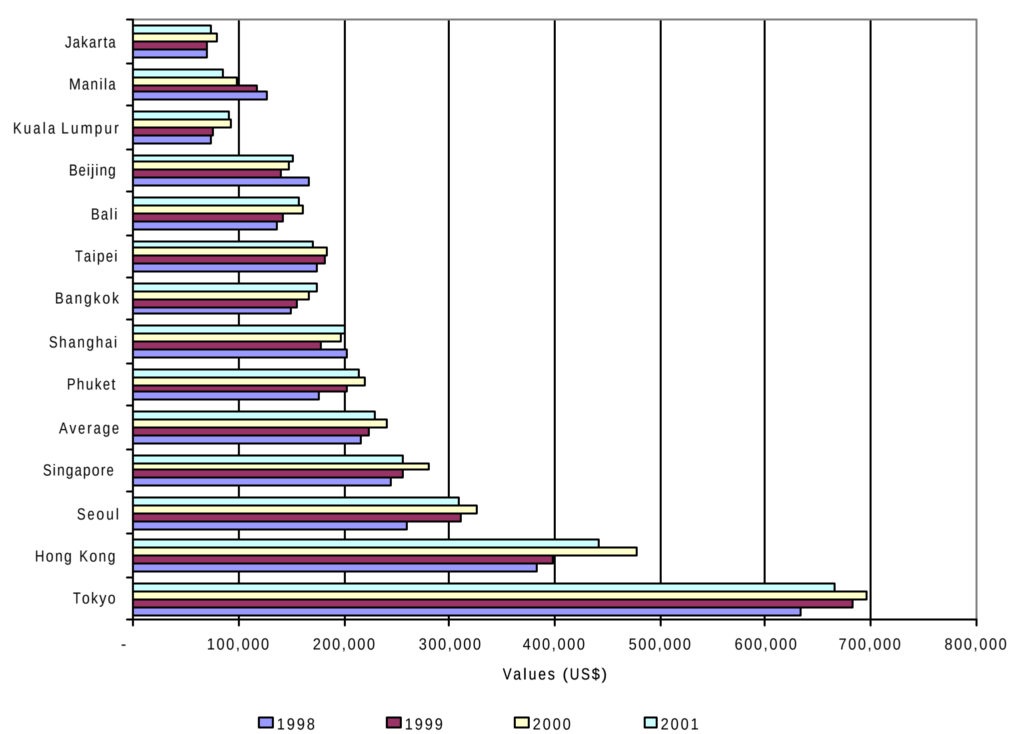
Singapore

Like many other countries in the region, Singapore was hit by the global economic slowdown. With IT and electronics products accounting for half of its total production, Singapore's export-driven economy was instantly affected by the slowdown in the US economy. In fact, with a negative Gross Domestic Product (GDP) of 2.2% in 2001, the city-state ranked as the worst performing country in Asia and experienced its worst full-year economic contraction since 1964. In addition, with 2001 arrivals from the US and Japan shrinking by 11% and 19%, respectively, compared to 2000 levels, five-star hotels saw their key high-paying feeder markets diluting.

Consequently, both corporate and leisure demand decreased and five-star hotels offered discounted rates to protect their occupancy levels. Furthermore, as the Singapore dollar weakened against the US currency to levels not seen since 1990, US dollar denominated average room rates of five-star hotels in Singapore declined by approximately 9% in 2001 compared to 2000 levels.

As the Singapore economy is not expected to recover before the end of 2002, hotel supply and consequently, market-wide five-star hotel occupancy, are anticipated to remain unchanged. Market-wide ARR is likely to decrease marginally, both because corporate rates have been renegotiated below 2001 levels and because hotels are expected to accommodate a higher share of lower paying demand in order to maintain their occupancy levels. With cashflows under pressure, discount rates are considered likely to increase, thereby negatively affecting market values by approximately 10% compared to the previous year. With values still below development costs, new stand-alone hotel developments remain difficult to justify in Singapore. At the same time, owners are unlikely to sell their assets in the near future as values are still below 1996 levels. Consequently, the barriers to entry in the Singapore market remain high for hotel investors and operators. We expect hotel values to bounce back towards the end of 2002, in line with the recovery of the global and Singapore economies.

Table 3 Hotel Values per Room 1998-01 (US$)



Hong Kong

The service-oriented Hong Kong economy was widely affected by the global economic slowdown and the 11 September terrorist attacks. Gross Domestic Product in the Special Administrative Region declined repeatedly in the third and fourth quarters, officially establishing Hong Kong as being in recession. Over the year, GDP was estimated to have shrunk by 0.3% compared to 2000 levels. Although tourist arrivals increased marginally, mainly due to a strong increase in travellers from mainland China who tend not to use five-star hotel accommodation, market-wide five-star hotel occupancy in Hong Kong declined by approximately twelve percentage points in 2001 compared to 2000 levels. During the same period, the average room rate increased considerably, as hotels maintained their pricing strategy despite a drop in demand.

Although the outlook for 2002 remains uncertain, we consider that market-wide five-star hotel occupancy is likely to remain in line with 2001 levels, as no new hotels are expected to enter the market in 2002. However, with key high-paying feeder markets unlikely to recover significantly until the second half of the year, we anticipate that the market-wide US dollar denominated average room rate will decline marginally, negatively affecting the RevPAR of hotels in Hong Kong. With cashflows under pressure, discount rates are expected to increase, albeit marginally. Consequently, hotel values have declined by approximately 8% compared to 2000 levels. With values still below development costs, new projects remain difficult to justify. Furthermore, with hotel values still under pressure and below pre-crisis levels, few owners are inclined to sell their interest in hotels in Hong Kong. As such, like Singapore, the barriers to entry in the Hong Kong market remain very high. We anticipate that values will recover slowly during the second half of 2002.

Tokyo

The 1990s were particularly difficult for the world's second-largest economy. Despite Prime Minister Koizumi's new government, 2001 was an unfortunate reminder that Japan is far from being done with its lagging economy. With Japan mired in a deflationary spiral in spite of a billion-dollar stimulus package, the economic performance for 2001 was disappointing. As arrivals from the US, Japan's key feeder market, dropped in response to the slowdown in the US economy, particularly after 11 September, most five-star hotels in Tokyo experienced a decline in both their occupancy and average room rate. During the same period, food and beverage revenue, a key source of revenue for hotels in Tokyo, remained stagnant. This is due to fewer local companies hosting events in hotels, as alternative venues became more affordable and popular.

Japan's economic outlook for 2002 is still obscure and no major growth is forecast. With international demand levels unlikely to improve until the US economy rebounds, five-star hotels are likely to focus increasingly on regional and domestic demand to maintain occupancy levels, thereby negatively affecting ARR. Moreover, as the room inventory is expected to increase significantly in the short to medium term with the opening of the Four Seasons in 2002, the Grand Hyatt in 2003 and the Mandarin Oriental in 2006, the five-star hotel market is expected to become increasingly competitive. Thus, potential growth in cashflow appears to be somewhat limited. As a consequence, initial yield and discount rate requirements of hotel investors in Tokyo have increased, as have the requirements of hotel lending institutions, negatively affecting values by approximately 5% compared to the previous year. With hotel values well below pre-crisis levels and replacement cost values, transactions and stand-alone hotel developments are unlikely to materialise in the short to medium term. As such, the barriers to entry in this market will remain high.

Seoul

Unlike many other countries in the region, the South Korean economy performed better than expected and avoided a recession. Hotel performance in the first half of 2001 was generally in line with the previous year, both in terms of occupancy and ARR. However, five-star hotels were affected by the 11 September events, mainly due to a sharp drop in Japanese and US demand during the last three months of the year.

However, with Japanese demand showing early signs of recovery in December and the Soccer World Cup being cohosted in South Korea, demand for five-star accommodation is considered likely to rebound in 2002. However, with cashflows still under pressure, particularly in the short term, hotel values in Seoul have decreased marginally, by approximately 6%, over the previous year.

As hotel values are still below 1997 pre-crisis levels and well below development costs, new developments are likely to remain difficult to justify. However, with limited new supply entering the market, the outlook remains positive and hotel values are expected to improve within the coming year. Nevertheless, the barriers to entry remain high, with few realistic acquisition and development opportunities being available.

Taipei

Taiwan's trade-driven economy was noticeably hit by the global economic slowdown, with the country's GDP contracting by approximately 2% in 2001. Five-star hotel performance, historically soft in Taipei, decreased sharply due to a decline in US, and to some extent, Japanese demand. Market-wide occupancy declined by approximately three percentage points whilst ARR fell by a record 15% between 2000 and 2001.

Despite Taiwan's recent entry into the World Trade Organization (WTO), domestic and international demand is expected to remain weak. As such, the market-wide five-star hotel market occupancy level is expected to remain unchanged in 2002, mainly because no new supply is expected to enter the Taipei market. However, average room rates are expected to remain under pressure, negatively affecting hotel cashflows. In addition, with Taipei's uncertain outlook, investors' risk perception has risen. Lending criteria of financial institutions have also increased. Consequently, hotel values in Taipei have declined by 8% in 2001 compared to 2000 levels. With values well below pre-crisis 1997 levels, realistic acquisition opportunities are limited. The outlook remains soft and new development seems unlikely as values are well below replacement costs. We therefore consider the barriers to entry in the Taipei five-star market to be high.

Manila

Whilst the Philippines was only marginally affected by the 1997-98 regional crisis, the recent US economic slowdown and terrorist attacks had a significant impact on the country's economy. As the US is one of the Philippines' main trading partners, five-star hotels experienced a remarkable drop in demand. Consequently, both occupancy and average room rates decreased in Manila. The country's tourism prospects have been further dimmed with the recent linkage of the local separatist Abbu Sayyaf with Bin Laden's Al-Queda terrorist organisation. As the administration of the current president, Gloria Macapagal Arroyo, is struggling to get the country back in shape, demand is not expected to grow considerably in the next year. Consequently, cashflows remain under pressure and investors' return requirements high. Furthermore, local banks are reluctant to finance hotel developments or acquisitions. As a result, hotel values have declined by a dramatic 15% compared to the previous year. With values well below development costs and little opportunity to improve cashflows, the barriers to entry for hotel developers, investors and operators remain very high in Manila.

Kuala Lumpur

Already affected by the global economic downturn, Malaysia was hit even harder by the 11 September terrorist attacks in the US, with non-Muslims fearing Malaysia's creeping Islamisation. Despite international arrivals to Malaysia recording an impressive growth level of 25% in 2001 over 2000, five-star hotel occupancy rates in the country's capital remained essentially unchanged. Although demand from Europe remained stable, US demand dropped by 21%, negatively affecting five-star hotel performance in Kuala Lumpur.

As Malaysia's economic downturn is likely to continue into the middle of 2002, the government's efforts to promote leisure tourism are likely to remain vain, as Kuala Lumpur five-star hotels rely essentially on corporate demand. Furthermore, with an oversupply of rooms in the Kuala Lumpur five-star hotel market and 1,453 rooms in the pipeline over the next three years (Westin, Le Meridien, Hilton), cashflows will continue to remain under pressure in 2002. At the same time, investment return requirements remain relatively high and local finance is practically impossible to obtain at the moment. Consequently, hotel values have declined by approximately 2%. Yet, with the government likely to divest some state-owned assets, including some hotels, as well as Malaysian conglomerates looking at ways to exit the hotel industry, some opportunities may arise for investors, albeit at a high price.

Jakarta

Still struggling with the 1997-98 political and economic turmoil, Jakarta is now facing a global economic slowdown. Although, preliminary reports suggest that the economy grew by 3.5% in 2001, a significant slowdown in the fourth quarter of the year was recorded. International arrivals to Indonesia increased marginally by 1.7% in 2001, mainly during the first nine months of the year. As supply of rooms in the five-star segment still exceeds demand in Jakarta, market-wide occupancy remains one of the lowest in Asia. Although the average room rates of five-star hotels have remained largely unchanged, they rank among Asia's lowest, with little opportunity for improvement in the short term.

Economic growth in the first half of 2002 is likely to be constrained. Furthermore, key high-paying feeder markets in Europe, Japan and the US are expected to decline as the business climate has worsened since 11 September. With a significant oversupply of rooms in Jakarta, cashflows remain under pressure. As the long-term economic, political and industry outlook remains bleak, investors and lenders are likely to show little appetite for hotels in Indonesia. Hotel values have declined further by approximately 7% and are now among Asia's lowest values on a per room basis. We consider this situation is likely to remain unchanged, at least for the next twelve months.

Bali

Five-star resorts in Bali performed well during the first nine months of 2001, with occupancy and average room rates exceeding 2000 levels. However, in the aftermath of 11 September, demand from international key feeder markets fell drastically. In fact, against all expectations, arrivals at Ngurah Airport by the end of 2001 were 3.2% below 2000 levels. With demand from Japan and Europe, key sources of demand for five-star resorts, declining substantially, any gains made during the first nine months of the year were largely diluted by the losses incurred during the last three months of the year. At year-end, five-star resorts recorded an occupancy lower than 2000 levels and a marginally higher ARR.

With increased risk perception of the destination, leisure travellers and MICE groups are expected to prefer safer destinations, particularly in Thailand. This is likely to negatively affect the outlook for the resort hotel market in Bali. Occupancy and average room rates of five-star resorts are expected to decline and return assumptions to increase, albeit marginally. Although hotel values have declined by approximately 3% compared to the previous year, five-star hotel values are expected to bounce back from 2003 onwards, provided the market conditions remain stable. However, with new transactions unlikely and development difficult to justify, the barriers to entry in one of Asia's premium destinations remains high. Nevertheless, we consider that Bali could offer great value in the long term. It is therefore anticipated that investors would pay a premium for hotel assets in this market.

Bangkok

Thailand's economy continued to grow by approximately 1.8% in 2001. Although tourist arrivals in 2001 fell short of the Tourism Authority of Thailand (TAT)'s projections, arrivals increased by approximately 4% over 2000 levels. Whilst room supply remained relatively constant, demand increased significantly between January and September 2001, resulting in an increase in occupancy and average room rate. However, as international arrivals from key feeder markets declined significantly in the last quarter of the year following the 11 September events, occupancy rates of five-star hotels plummeted. As such, at year-end, occupancy levels of five-star hotels were marginally lower than in 2000, whilst the average room rates were considerably higher.

Although supply is expected to increase marginally with the opening of the 395-room Conrad Hotel in late 2002, market-wide occupancy is expected to remain in line with or improve marginally over 2001 levels. However, with corporate and leisure demand from Europe and the US expected to be lower in the first semester of 2002 compared to the same period in 2001, average room rate growth is anticipated to be stagnant. Nevertheless, we consider the market outlook to remain relatively positive, particularly compared to other cities in Asia. However, as local banks remain reluctant to finance hotel projects and owners have high pricing expectations, Bangkok remains a difficult place in which to complete hotel transactions successfully. Consequently, investors are likely to have to pay a premium for good assets in Bangkok. We consider that hotel values have remained relatively unchanged in 2001 with a marginal increase of 3% over the previous year.

Phuket

Five-star resorts in Phuket performed well during the first nine months of 2001. However, demand softened during the last three months of the year as long-haul demand from Europe declined considerably. At year-end, market-wide five-star resort occupancy rates had fallen by approximately 12 percentage points compared to 2000 levels, whilst average room rates had increased by 7%.

Demand for five-star hotel accommodation is anticipated to rebound, thus enabling resorts to marginally improve their occupancy rates in 2002. However, with international tour operators expected to renegotiate room rates in view of the global economic downturn, average room rates are expected to decrease marginally. As Phuket continues to be Asia's most premium destination, investors still have to pay a premium. Consequently, hotel values have fallen by approximately 3%, despite the market's strong reliance on long-haul demand from Europe. Unlike many other destinations and cities in Asia, resort development costs are often below hotel values, thus making hotel development justifiable in this destination.

Shanghai

In the midst of the global economic slowdown, China entered the WTO and recorded an estimated 7.3% GDP growth in 2002. Furthermore, with Shanghai the focus of all attention in China, five-star hotels have not been affected as badly by 11 September. As such, due to strong growth in demand and relatively slower growth in supply in 2001, five-star hotels in Shanghai were able to increase their average room rates whilst somewhat maintaining their occupancy levels.

Although demand is expected to increase further in 2002, 1,200 additional rooms, including the Four Seasons, JW Marriott and Westin hotels, will enter the Shanghai market in 2002, thus putting pressure on occupancy and average room rates. However, as the long-term outlook for this market remains positive for investors as well operators, hotel values in Shanghai have increased by approximately 2%.

Beijing

With demand for five-star hotel accommodation in Beijing recording a slight drop in 2001, market-wide occupancy and room rates have declined. Furthermore, with the combination of 11 September and the opening of the Grand Hyatt and Marco Polo hotels adding 895 rooms to the room inventory in the last quarter of 2001, market-wide five-star hotel occupancy and room rates have been particularly tested in the second half of the year.

With demand anticipated to increase in 2002, the outlook for five-star hotels is positive. Market-wide occupancy and average room rates are expected to increase marginally in 2002, with the Grand Hyatt and Marco Polo hotels performing their first full year of operations. With China entering the WTO and Beijing recently named host of the 2008 Olympic Games, more developments are expected to take place. Despite a disappointing performance in 2001, we consider the market outlook for Beijing to be positive. Hotel values in Beijing have increased by approximately 3%, setting the stage for further growth in the future.

Although like the Shanghai market, few transactions are foreseen in the short term, additional development is likely to occur, even if not all projects meet the financial mark. Oversupply remains a serious threat to the Beijing hotel market.

Conclusions

The global economic downturn and the 11 September events have affected hotel performance in key markets across Asia. This comes at a time when the hotel value growth recorded during 1999 and 2000 was expected to improve in 2001.

It is anticipated that in 2002, the effect of 11 September on international tourism is likely to wear off, leading to a global economic recovery in the second half of the year. In fact, as at 1 January 2002, five-star hotel performance in most Asian markets has already begun to stabilize. Most hotel markets have proved to be more flexible than expected and cashflows have slowly started to recover. Investors' risk perception of the region is also likely to improve in line with the markets' ability to improve over last year's performance levels. Subsequently, hotel values are also likely to rebound.

Although potential hotel investors are likely to adopt a "wait and see" attitude during the first half of 2002, we expect buyers and lenders to return to the market by the second half of the year.

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HVS International

Since 1980, HVS International, the leading global hospitality consulting organisation, has provided financial and valuation consulting services for over 20,000 hotels in more than 75 countries. Its professional staff of more than 250 industry specialists offers a wide range of services, including market feasibility studies, valuations, operator searches and hotel brokerage and investment services. Through its divisions, HVS supplies unique hotel consulting expertise. HVS International is the industry's primary source of hotel sales information. Its databases contain information on more than 10,000 hotel transactions. HVS is also the most comprehensive source of hotel compensation data.

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