



2020

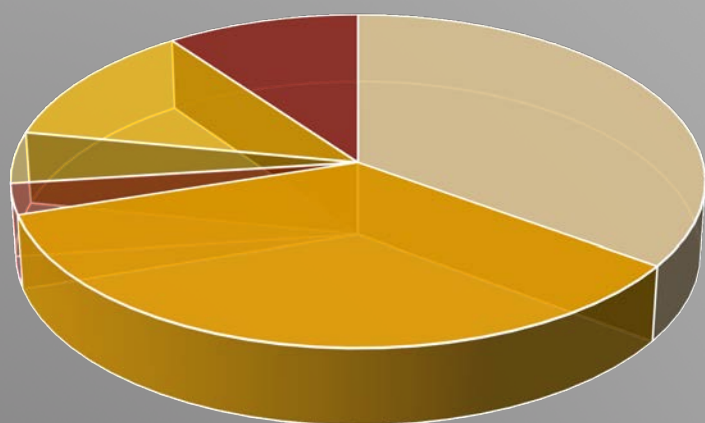
China Hotel Investment and Asset Management Outlook

Introduction

The coronavirus outbreak in 2020 has been a severe challenge for the hotel industry in China, putting the risk management capability of each operating hotel to the test. While from the perspective of hotel investment and asset management, which are more strategic and forward-thinking than day-to-day operation, the industry will recover from the downturn eventually, the impact of this outbreak will force investors to reconsider their strategic planning in hotel investment and in asset management. It's crucial for investors to take a positive stand and refocus on the essentials of hotel investment: to evaluate hotel assets from a corporate development standpoint, and to build a more rational evaluation and development plan for the investment, management, and exit strategies for hotel assets. At the beginning of the new decade, we launched a survey regarding hotel investment and asset management related issues, and compiled 15 key trends for the hotel investment and asset management industry in China based on an in-depth analysis of the survey results.

The survey included 15 questions which aimed to gauge the hotel investors' and stakeholders' insights regarding the asset management of new-build hotels and existing assets in the year of 2020. From the 226 responses received, respondents are mid-to-senior level staff from state-owned enterprises, real estate development companies, asset management companies, funds, investment banks, and others. We would like to express our sincere appreciation to all the participants for their valuable insights and contribution to this survey.

Sample Distribution by Company Type

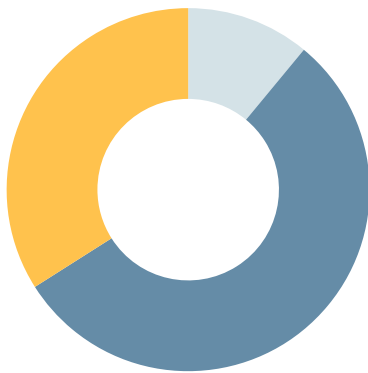


- 35% State-owned Enterprise
- 35% Real Estate Developer
- 12% Hotel Operator
- 10% Others
- 5% Asset Management Company
- 3% Funds/ Investment Bank

Sample Distribution by Ownership



Existing Asset Renovation Is The New Trend



- Existing Asset Renovation: **55%**
- Both New-build and Renovation: **34%**
- New Build: **11%**

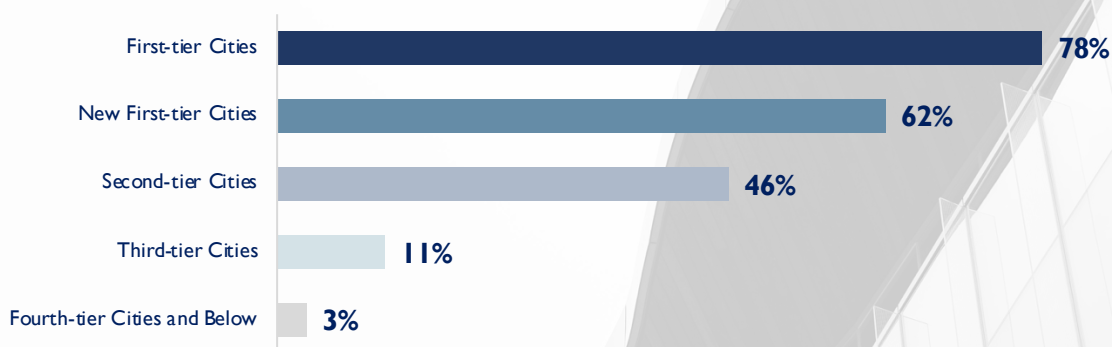
After 20 years of rapid growth, China's hotel market has gradually entered an era that focuses more on renovating existing asset. On the one hand, coupled with rapid urbanization and city development, land resources are becoming increasingly scarce and especially so in core cities, which resulted in a slowdown seen in new-build hotel investments. On the other hand, many older hotels are becoming less competitive due to aging facilities and outdated decoration styles. These properties are in desperate need of repositioning and renovation to improve their operating performance in order to release more potential return that match their land value and location. Meanwhile, under the weakening expected premium from land appreciation, many hotel markets are pressured by oversupply and excessive competition, suffering a declining performance and resulted in insufficient investment return. Investors need to be increasingly prudent and objective towards new-build hotel projects which require huge initial capital outlay. Consequently, although new-build hotel investments remain as the main contributor to the markets' new supply, existing asset renovation is becoming the focus of hotel investment nowadays.

Top Cities For Existing Asset Renovation:

First-tier Cities, And New First-tier Cities

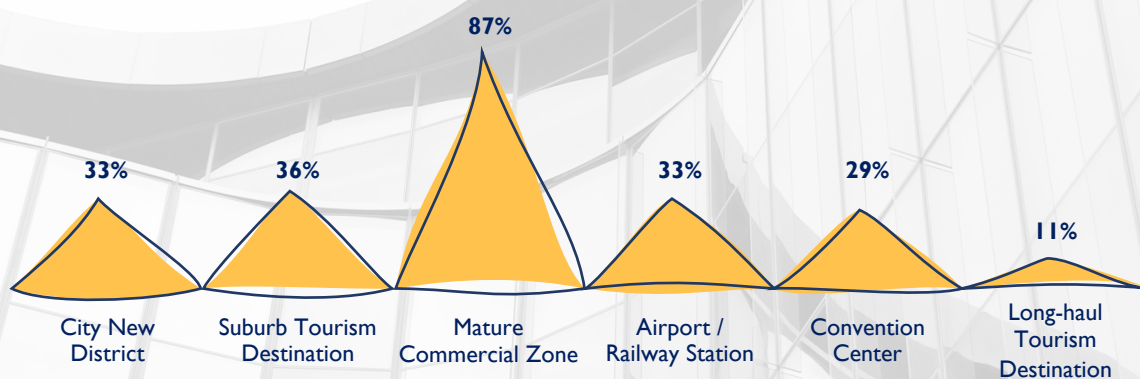
With robust economic activities, active investment scenes, and solid demand forces, first-tier and new first-tier cities have been the top choices for hotel investors. Compared to cities of other tiers, the hotel markets in first-tier and new first-tier cities have an early start, and have achieved a relatively mature development status. Thus these hotels' asset valuations are most favorably. However, due to factors such as aging properties and rising operating costs, many hotel assets are losing competitiveness in the market, and their performance can barely match the value of the prime location they occupy. Therefore, the hotel investment trend in China is gradually shifting towards enhancing market competitiveness and revenue-generating ability through market repositioning and facility optimization.

Investment in renovation and facility upgrading enable older hotels to match the current design trends and meet dynamic consumer demand at the same time, while fully 'unlock' prime location value, upgrade space utilization and maximize area effectiveness through innovation and property re-planning. Le Joy Hotel and BEI Zhaolong Hotel serve as good examples in this category.



Hot Spots For Existing Asset Renovation:

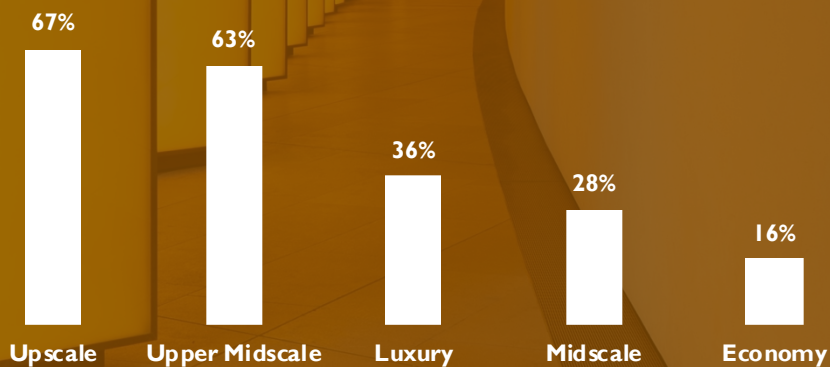
Mature Commercial Zones



The renovation timing of different hotel assets is closely related to the corresponding development sequence. Mature commercial zones, or downtown areas, are usually the starting point of a city's hotel investment, due to these locations' relatively early and rapid economic development, commercial activities, and transportation system. With decades of development as groundwork, hotel assets in mature commercial zones naturally become the first to enter the renovation cycle. Meanwhile, hotel assets in areas with secondary urban development priority (e.g. city new districts, transportation hub areas, convention centers and surrounding areas, etc.) are still in their growth or maturing stage, thus require less urgent renovation effort. Hotel assets in the suburb or long-haul tourism destinations are mostly in their early or growth stage resulting from consumers' increasing expenditure and demand for travel in recent years; hence have a limited demand for renovation as of now. As such, the hot spots for hotel asset renovation are mature commercial zones.

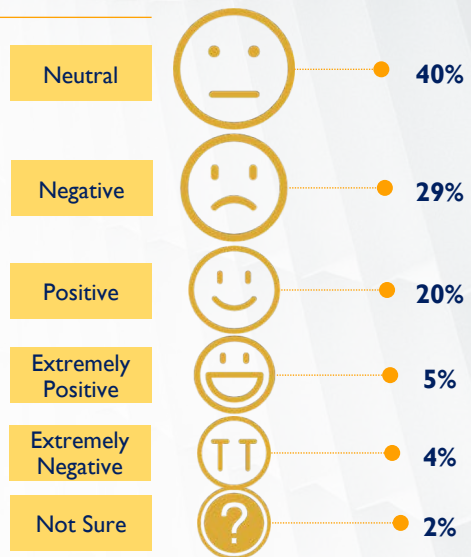
The Key Focus Of Existing Asset Renovation Upscale And Upper Midscale Hotel Properties

Most respondents in this survey are owners or investors with solid financial strength who adopted an asset-heavy strategy. In their current hotel asset portfolios, upper midscale and above hotels are the major constituents, and such properties' future cash flows and asset upside potential are equally important for return evaluation. Midscale hotels, which require a relatively low initial investment and are driven solely by cash flow returns, are typically not a focused asset allocation type for our surveyed asset-heavy investors. The luxury hotels are not the top choice for existing asset renovation either, since both their development sequence and quantity trail behind the upscale and upper midscale hotels. This is primarily due to the constrained pace of economic development and recent nationwide consumption decline.



Investment Expectation On New-build Hotels Is **Conservative**

Real estate companies have always been the central force of the hotel investment business. Under the restricted monetary policy in recent years, the real estate industry has suffered tightened policies on bank loans and trust financing, and the real estate market has undergone a tremendous change. With the high growth era for real estate industry approaching to an end, real estate companies' passion for hotel investment are declining. Consequently, the growth of the capital-heavy new-build hotels is tapering also, as more than 70% of respondents surveyed indicate a neutral or conservative attitude towards the outlook on new-build hotel investments in 2020.



The Most Competitive Battlegrounds For New-build Hotel Investment: **New First-tier Cities And Second-tier Cities**

As the main arena for hotel investment, hotel markets in first-tier cities are already saturated during the past 20 years: rising land price, limited land supply, and intensified competition for resources by office and service apartment developers have led to a declining growth of new-build hotel investments in first-tier cities.

Nevertheless, opportunities for hotel investment recently emerged in new first-tier cities and second-tier cities. Under favorable government policies and rapid development of urbanization, new first-tier cities and second-tier cities are enjoying an accelerating economic growth. Development of new urban districts releases new land supply, which through stimulating investment in new-build hotels helps to optimize city infrastructure and diversify accommodation options. For third-tier cities, hotel investors tend to be more cautious, considering their relatively weaker economic drivers, transportation accessibility, and demand intensity.

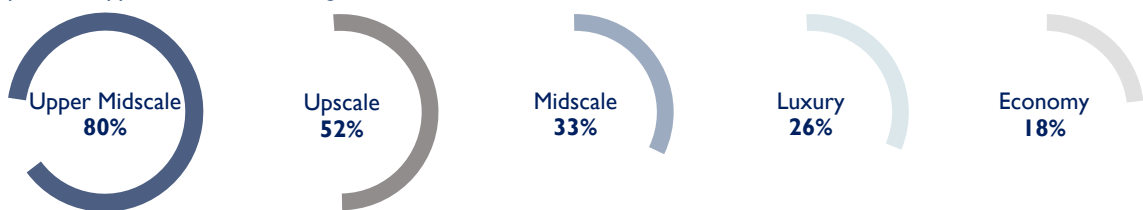


New-build Hotel Investment Shows Preference On Upper Midscale Hotel Segment

With the slowdown of economic growth and tightening of real estate regulations and policies, investors have become increasingly pragmatic when dealing with asset-heavy investments. Gone is the blind pursuit of superficial luxuries, replaced by an increasing focus on hotel products with high asset value and steady cash generating efficiency. Under the new criteria, investors show an increasing preference towards upper midscale hotels, which typically possess strong brand and asset image.

On the demand side, the high-end spending spilling over into smaller markets, as well as the increasing nationwide mass market consumption have contributed to the fast growth of upper midscale hotel as well. For both business travelers and leisure vacationers, cost effectiveness has become a key criterion for making hotel selection decisions.

Driven by forces in both supply and demand, the new-build hotel investment scene is experiencing a structural shift, and we expect the upper midscale hotel segment will embrace a boom in investment activities.

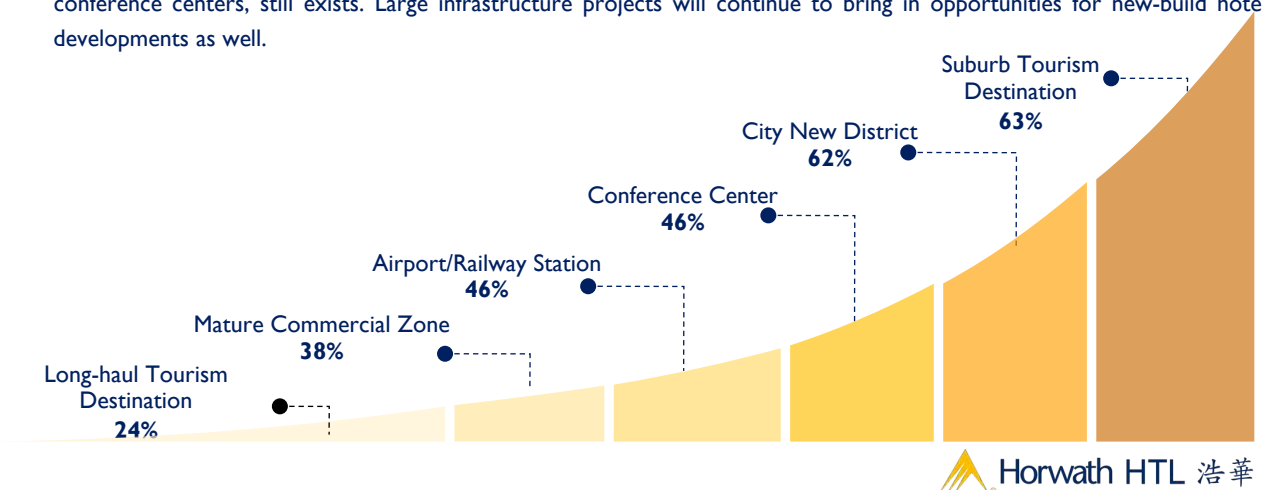


Key Areas For New-build Hotel Investment: City New District And Suburb Tourism Destination

Under city expansion trend, a large or medium sized city is usually polycentric with several new district developments. Generally, newly developed districts enjoy a large amount of land supply, favorable policies, and a relatively high standard in related infrastructure development. City new district development, therefore, attracts opportunities for new-build hotel investment.

Driven by consumption upgrade and development of interactive experiential economy, holidays and weekend short trips in city suburbs have shown increasing popularity. Compared to traditional destination tourism, vacationing in city suburbs come with a lower cost in terms of time, energy, and expenditure. With the development of holiday system and the optimization of the transportation network, the growth of leisure market in city suburbs will be further stimulated, and suburban leisure is expected to be a new growth driver for the tourism industry in China. Consumers' peaked interests on suburban leisure and wellness tourism also inspire new ideas for accommodation product investments.

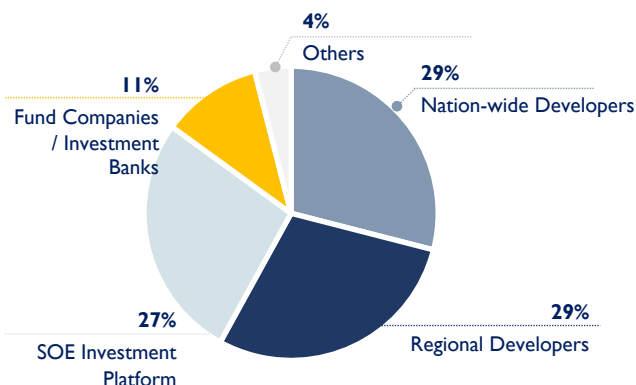
In addition, the focus on traditional investment regions with high traffic volume, such as city transportation hubs and conference centers, still exists. Large infrastructure projects will continue to bring in opportunities for new-build hotel developments as well.



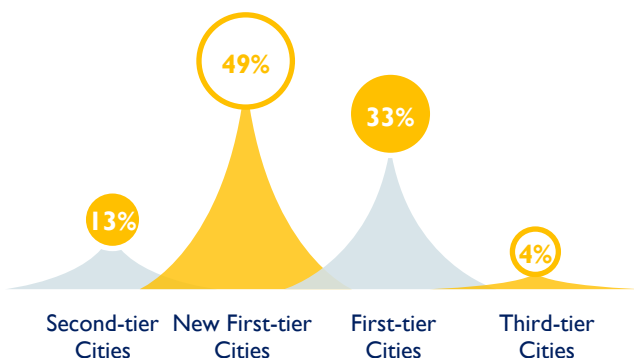
Real Estate Developers And SOE Investment Platforms Are The Main Investors Of Upper Midscale And Above Hotel

With solid financial strength, real estate developers and SOE investment platforms will continue to be the dominating investment entities of upper midscale and above hotels in the future. Nation-wide real estate developers, regional developers and municipal investment platforms make up the three main pillars of the hotel investment.

Professional fund companies and investment banks, who particularly value ROI and are less sensitive to the added value brought by high-end hotels, are usually not a big fan of such type of hotel investment. It is believed that the composition of the investment entities will not change significantly in the future.

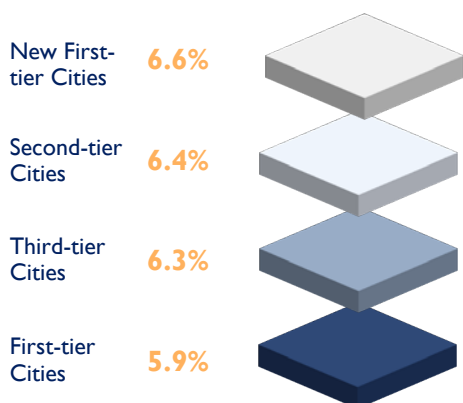


Transactions Of Upper Midscale And Above Hotels Concentrate On New First-tier Cities And First-tier Cities



With robust economic development, industry structure, transportation network, market capacity and growth potential, new first-tier cities and first-tier cities have excellent investment potential and a strong appeal for hotel transactions that focus on the capability of generating cash flow. Asset transactions in second-tier and third-tier cities are relatively less active.

Cap Rate Of Upper Midscale And Above Hotels Ranges From 6% To 7%



Respondents have a relatively consistent answer for the upper midscale and above hotel assets' cap rate. There is no significant difference in the capitalization rates between cities at various levels, which are distributed in the range of 6% to 7%. Generally speaking, the more developed the city where the hotel assets are located, the higher the asset value, and the lower the expected level of cap rate. The data stated that the cap rate of the first-tier cities is the lowest, which is attributed to the high property value, strong asset security, and relatively stable returns in the first-tier cities. It's worth noting that the lower cap rate in first-tier cities does not necessarily mean lower investment return. On the contrary, the considerable return of cash flow and expected land appreciation driven by the scarcity of land resources make ROA in first-tier cities far ahead of others. In other levels of the market, respondents have higher expectations on hotel assets' cap rate since the property value and revenue level could be lower.

Cost Control Is Perceived As The Key To Asset Management

Among the 6 options, “Cost Control” is selected as the most important means to improve the effectiveness of asset management during hotel operation, followed by “Revenue Driven”. Compared with others, Cost Control focuses more on the micro level of operation. It is more practical for each operating hotel to control specific expenditures in daily operation. The rapid development of innovative technologies and intelligent systems further brings opportunities for Cost Control. On the contrary, although many measures such as sales channel development, customer structure modification, and space efficiency improvement are all helpful in driving revenue growth, revenue growth will be limited to a certain extent by the macroeconomic environment, supply-demand relationship, and the impact of special events. Therefore, during this revenue growth bottleneck period, controlling costs can quickly help hotels improve their financial performance and investment return.



Market Supply is Crucial in Affecting Investment Return

Hotel, as an ancillary property of a commercial real estate development project, has achieved rapid growth during the period that real estate business was profiteering. Now, impacted by economic development slowdown, hotel management companies are turning from the first-tier city to second-tier or even lower level cities. New hotel supplies continue to enter the market, and non-standardized accommodation counterparts like homestay or Bed & Breakfast are increasingly popular, raising a concern of oversupply in the lodging market. This oversupply situation undoubtedly put significant pressure on hotel performance, forcing some hotels to sacrifice ADR in order to stabilize its occupancy. As anticipated, for some specific hotel markets, before they officially enter a mature development stage, the imbalance between supply and demand will continue to be the key general factor that influences the revenue level of hotels.

In addition, respondents also indicated that the high initial capital investment is another reason for the unsatisfactory return on investment. A large number of hotels in China are not developed based on market driven demand. These hotels typically lack reasonable market positioning, effective space utilization and proper facility programming. As a result, it is easy to over-invest on such hotel projects, driving up the investment cost level of the entire hotel industry. When the denominator, initial investment cost, is too high, even with an acceptable operation performance, investment return may still face severe challenges.





Respondents' Focus Lies on Refined Asset Management

Through the past decades, China has been a mega hotel investment market. However, the required hotel management skill set can hardly keep up with hotel investment. Influenced by a synchronized slowdown of global economy and the strict regulation of domestic real estate policies, more and more hotel investors and managers have begun to pay attention to hotels' capability to generate cash flow. Respondents stated that fine tuning asset management, rather than existing asset renovation and new-build hotel development, will be their top priority in 2020.



Note : The numbers above are positively correlated with respondents' perceived importance, with 0 as the least important and 100 as the most important.

Focus On Both Collaboration With Established Brands While Fostering Own Ability to Operate

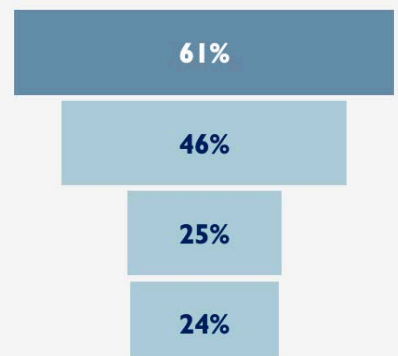
Mature membership, sound reservation system, solid management model, and the brand premium are the primary reasons that investors choose to cooperate with hotel management companies. However, in addition to continuing to work with established brands, respondents stated that shaping their own ability to operate hotels is also a new direction they seek in 2020, aiming to operate independently, adopt a franchise model, or develop their own brands in the future. Furthermore, when asked about operation model, almost half of the respondents choose to work on optimizing existing operation models and brands, which means that part of refining asset management is the reform on optimizing operation models with asset value maximization as the main driving force.

Continue To Collaborate With Mature Brands And Foster Own Ability to Operate At The Same Time

Optimize Current Operation Models / Brands

Develop New Brands

Keep Going With Current Operation Models / Brands



Conclusion

Although the Black Swan Event, Coronavirus outbreak, may postpone the investment plans in 2020, the crisis has also prompted a rethink on past investment and management decisions. As we refocus on the business incentives of hotel investments, the evolving demand trends, pragmatism, efficiency, and innovation will all be the fundamentals of future development in the hotel industry. Prompted by rational and logical asset management, existing asset renovation will be the next trend in the hotel investment scene.

In terms of existing asset renovation, upscale and upper midscale hotels in mature commercial zones of first-tier and new first-tier cities will be the first to step into the renovation stage. As for new-build hotel investment, competition for upper midscale hotels in newly developing districts of new first-tier cities and suburban tourism destinations is fierce.

Market supply and investment/acquisition cost are the core factors that affect hotel investment returns. To achieve better performance on ROI, fine tuning asset management has increasingly become the focus of asset owners. Cost Control and Driving Revenue have become the top priorities of asset management. Facing the negative impact from the Coronavirus outbreak and the declining role of the real estate industry in economic development, refined hotel asset management will gradually be put into practice. In the future, hotel investment and existing asset renovation will be more driven by efficient space utilization that strive to maximize asset value as well as business performance.





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