



Q3
2011

Australian Hotel Market Outlook

The Deloitte Tourism, Hospitality & Leisure (THL) Market Outlook - Q3 2011 reports on the performance of the Australian hotel industry to June 2011, based on data until the March 2011 quarter as published by the Australian Bureau of Statistics (ABS), and extrapolated through information collected by STR Global.

Based on a correlation of historic market performance with state-by-state indicators for sectoral performance as reported by Deloitte Access Economics, we also present a forecast for each market until year-end 2014. The economic commentary providing the background for this outlook is derived from the Deloitte Access Economics Business Outlook - June 2011.

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The 'two-speed' screws are tightening

The weather wiped out what would otherwise have been continuing growth in Australia's economy in early 2011. Mines couldn't be worked, sugar, banana and cotton crops were destroyed, livestock drowned, grain crops were flooded, building sites were abandoned, employees couldn't get to work, shoppers couldn't get to the stores, and tourists stayed away in droves – the impact was huge.

Moreover, when news of just how much Australia's economy had shrunk in the opening months of 2011 finally came out, that figure was worse than most had imagined.

Most notably, consumers remain cautious. They haven't had any lack of income growth, but they have been trying very hard to save rather more substantively than they did in times past.

And, if interest rates do rise in the coming year, Australian families are now so indebted that any such increase in the cost of credit is likely to see saving rates lift further still.

The result is that the domestic tourism sector is weak at present, but it is not all necessarily bad news looking forward. Australia is, after all, in the midst of an unprecedented resources boom and there will be a range of dividends from that: more jobs, wage growth, profits and government revenues, which are all boosting growth in the corporate accommodation sector.

The global economy

Forecasters are dialling down estimates for advanced economic growth in the wake of a surge in commodity prices and Japan's awful earthquake.

Out of the six largest advanced economies, only the US and Germany are bigger today than three years ago, while government spending cuts and tax hikes are cutting a swathe through prospects for Europe's drowning periphery, slowing down growth everywhere from the UK to Italy, Portugal and Greece.

That said, current fears are overblown, and recovery is continuing. Elsewhere, China and India are starting to cool. But that slowdown – like the associated lift in their interest rates – is modest so far. That not merely leaves their short term outlook excellent, it also means overheating risks remain. With developed economies doing better and emerging economies only throttling back a bit, the upshot overall is continuing global growth both this year and next.

The Australian economy

Yes, it is tough out there for many families and businesses. Most of Australia's growth engines are misfiring: (1) families are saving rather than spending; (2) stimulus has run its course, and its absence will be keenly felt; (3) housing construction – a pocket rocket in past recoveries – is limping into this one as interest rates down out population pressures; while (4) our export gains from resource sales volumes are being mostly matched by lost sales from tourists, manufacturers and international students. Add in the huge costs of floods and cyclones, and no wonder people are shaking their heads at hints that the Reserve Bank may raise rates further.

However, the flood and cyclone costs were a one-off, and production is already rebounding from those losses. One growth positive is enormous: businesses (especially miners) want to spend a fortune on adding to their capacity, and that will power continuing recovery even if they only achieve a fraction of what they are aiming for. Growth prospects are very narrowly based however: one sixth of Australia's economy has to account for almost two thirds of its growth in the coming financial year. We think that should be achievable though.

Sectors

On the sectoral front, the 'two speed economy' pressures on the industrial landscape are intensifying. That has been partially masked by the striking impact of floods and cyclones, which hurt mining exports. But the continuing stellar strength of the \$A is combining with expectations of further interest rate increases ahead, exerting pressure across a range of sectors.

That is no surprise. After all, value added per employee in mining is seven times the average, so the desire to see that sector contribute more to national income has set off a scramble that will boost construction of mining facilities before it can lift the mining sector itself. But both these two will struggle to grow as fast as they'd like as skill shortages will keep them on a short leash.

In turn, the pressure from high exchange and interest rates is making life extremely uncomfortable in much of manufacturing, as well as in tourism, parts of education, for retailers, and in farming. Moreover, as the straitjacket on skilled workers is tightened over the next two years, many of the latter list of sectors will also find they face unwelcome wage pressure from competition for employees from the mining and construction sectors.

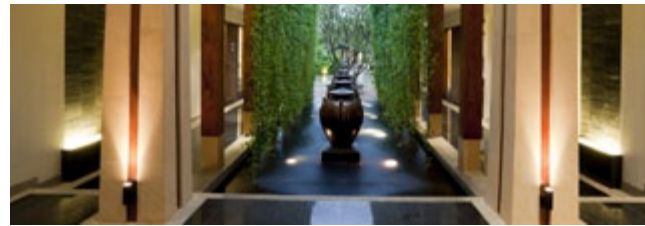
Economic impacts for the Tourism, Hospitality & Leisure sector

Leisure-based tourism is a discretionary spend, and as such directly related to retail spend. Unfortunately, retailers have had to sail into the teeth of a howling headwind in the last few years. The classic signs of caution are there to be seen, with food spending leading the retail leader board list, whereas most discretionary categories have been lagging badly.

The global financial crisis gave the world a scare. And although Australia's economy escaped much of the damage seen elsewhere, the damage to the psyche of savers was just as marked here as in the rest of the developed world. This surge towards savings has probably not yet finished. Interest rates will probably head up a bit further from here, and chances are utilities prices will as well. The resultant squeeze on family incomes may see savings rates climb further still in the next little while. That said, we expect consumer, retail and leisure spending will once more be growing in lock step with family incomes a year or 18 months from now (that is, once rate rises have been absorbed).

Our export earnings have soared more than 30% in the three years to 2010, but mostly because we are selling at higher prices rather than because we are selling higher quantities. That leap in world prices for industrial commodities has had two effects on volumes: it has instituted an investment program which will eventually lift resource export quantities, but it has also resulted in sharp and rapid bad news for export volumes of pretty much everything else: farm goods, manufacturing, tourism and international student numbers all have to grapple with the higher interest and exchange rates that characterise commodity booms.

Tourism and international education are the two key sectors which dominate our service exports. Past 'growth heroes', both these sectors are now on the wrong side of Australia's two speed economy, with higher exchange rates combining with changed migration rules and a sharp competitive push from US colleges results in depressingly large falls in enrolments in key parts of the international education sector. At the same time, although numbers of inbound tourists did lift of late, it is hard to see visitor numbers sprinting any time soon. Although the \$A isn't the be-all-and-end-all of tourism prospects, it remains painful as long as the \$A is above parity with the \$US.



Australians are now holidaying in the rest of the world instead of at home, while foreigners are being deterred by the sheer strength of the \$A. And although the currency isn't the only driver of inbound tourism numbers, it has been the biggest mover on that front, and the pain of rising exchange rates will increasingly be evident in revised wholesale contracts for internationally based travel agents. That means the \$A exchange rate could experience no change from here and yet punters around the world will find Australia a relatively more expensive destination in six months or so.

The huge natural disasters in both New Zealand and Japan have not helped what are traditionally two key inbound tourism markets for Australia.

Yet although these are a series of important negatives for the recreation sector, it is worth remembering that – even in an economy amid the stresses and strains of 'two speed' pressures – business demand is on the rise. That is perhaps most evident in the hotel sector, and especially those hotels selling to business clients. Rising room occupancy rates have allowed hotels to edge up average room rates with further room rate rises expected in 2012.

Some of the earlier strengths in cafes and restaurants has faded of late, while the mooted poker machine reforms could also have an impact on this sector.

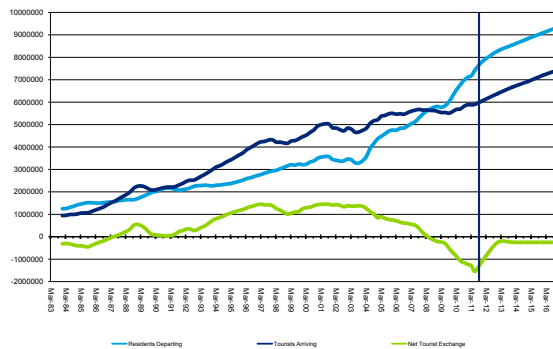
And then there is the grounding of Tiger Airways. Though still uncertain if it will ever fly again when writing this report, its grounding spells bad news for the leisure sector, especially in regional destinations, as it takes the cheapest airfares out of the Australian skies, creating opportunity for its competitors to hike up their fares. In times of a squeezed household wallet, this is pushing people back in their cars, putting destinations further afield out of reach for the main population centres.

Finally, as the straitjacket on skilled workers is tightened over the next two years, the service sectors will also find they face wage pressure from mining and construction, putting further pressure on the bottom line.

Visitor flow

According to the latest publication from the Tourism Forecasting Committee (TFC, May 2011), departures continue to outpace arrivals at Australia's shores, at ever increasing rates, resulting in an increase in the net visitor exchange, as demonstrated in the following graph.

Whilst Australia recorded some 1.5 million more arrivals than departures around the turn of the century, this began to reverse during the financial crisis in mid-2008 and has now reached a negative net outflow of more than 1.5 million visitors. The Tourism Forecasting Committee (TFC) is expecting this trend to revert almost instantly, as a result of both increased growth of international visitors and a normalisation of the continued increase in departures.



TFC expects domestic visitor nights to fall by 0.3% to 259 million in 2011 which is a downward revision from the previously expected 0.6% growth. The weaker short term outlook can be linked to the effects of recent floods and cyclones on travel coupled with the sustained and increasing strength of the Australian dollar (which makes outbound travel more attractive) and restrained consumer spending. The annual average growth rate of 0.3% in the longer term is similar to previous expectations with domestic visitor nights forecasted to be 266 million in 2020.

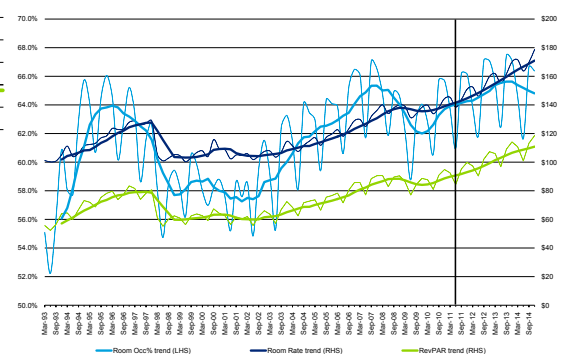
Australian resident outbound departures are forecast to grow by 10.1% to 7.8 million in 2011, which is an upward revision from the previous forecast of 7.7%. This growth is driven by the continued high value of the Australian dollar and strong growth in aviation capacity to many key outbound markets including China, Indonesia and the United States. The longer term outlook for outbound travel is slightly higher than previously forecast, with annual average growth expected to be 3.7% (rather than 3.2%) and departures to reach 10.3 million in 2020.

Inbound visitor arrivals are forecast to increase by 3.1% to reach 6.1 million in 2011 – a downward revision from the previous forecast (5.6%). This was due to rapidly escalating oil prices linked to political unrest in the Middle East; the continued slow pace of recovery in developed economies; and effects from the natural disaster in Japan. The longer term outlook remains similar to that previously forecast, with annual average growth expected to be 3.6% rather than previously expected 3.9% with inbound arrivals to reach 8.4 million by 2020.

Asia is expected to continue to lead the growth in inbound arrivals to Australia in the short and longer term.

For 2011, there has been an upward revision for arrivals from China (from 21.9% to 25.8%) and Indonesia (from 6.8% to 13.1%), as aviation capacity continues to increase. Arrivals from most other Asian countries are forecast to grow in line with previous expectations, or at a slightly increased pace. A notable exception is Japan, where arrivals have been downgraded substantially (from 401,000 to 293,000) in 2011, due to the recent natural disaster in that country.

Australia



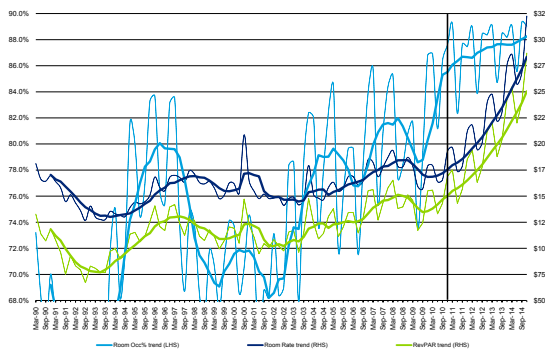
Australia-wide hotel performance is steadily improving from its RevPAR low at the end of 2009. This steady trend masks significant discrepancies between various markets, however, and more particularly between the leisure and business segments.

City-based hotels are generally recording excellent occupancy levels, close to capacity during midweek periods and thus providing only limited opportunity for further growth. RevPAR growth in the cities is therefore almost solely driven by rate improvement. Leisure destinations are not that fortunate, and are fighting to maintain occupancy levels, often at the expense of growth in room rates.

Our supply outlook shows a pushback on a number of hotel development projects, resulting in a slightly higher occupancy outlook in the short to medium term. Room rates are not growing as fast as we had hoped, and have been revised downwards.

Overall, our RevPAR forecast for Australia in 2011 remains unchanged at \$93 and 4.9% growth over 2010. We have increased our occupancy outlook from 63.5% to 64.3% however, at the expense of a slight reduction in rate growth, finishing the year at \$153, a 5.6% improvement over 2010. Our RevPAR forecast for 2012 was revised downward slightly, from \$100 to \$99, with slightly higher occupancies and lower room rates.

Sydney



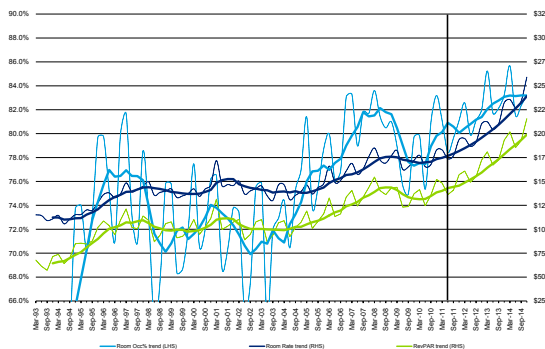
Sydney hotel occupancies have recovered quickly from the 2009 downturn, recording a record 86.4% for the 12 months to June 2011, with further growth expected. Our forecast for 2011 year-end occupancies has nudged up to 86.7%. Further growth can only be achieved through growth in the slower months, with our outlook for 2012 now at 87.4%.

The opening of the new hotel at Star City by the end of 2011, as well as the addition of more serviced apartments will add some much needed new inventory to the city, but only make a minor dent in overall performance levels.

Despite these record demand levels, average room rates are not growing as fast as anticipated, with the 12 months to June 2011 showing just over 7% growth. To reflect this cautious approach to room rate increases we have revised our 2011 year-end rate forecast down by \$4 to \$191, resulting in a still respectable RevPAR improvement over 2010 of 10% to \$165, representing the highest growth rate in the country.

Our expectations for 2012 are a bit more cautious but still very optimistic, with only a little more room for occupancy growth but a healthy 12% room rate growth. RevPAR for year-end 2012 is thus projected at \$187, down from \$193 in our previous projections.

Melbourne



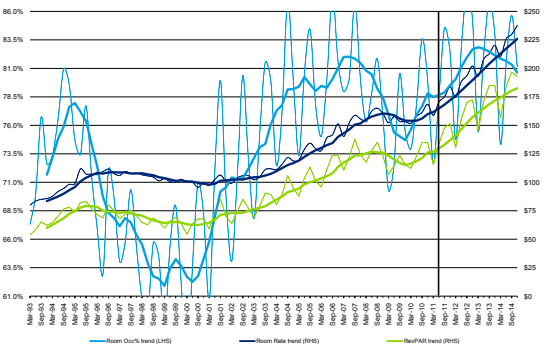
Whilst not as strong as Sydney and impacted by some substantial recent additions to supply, the Melbourne accommodation market continues to perform well, recording 80.9% room occupancy for the 12 months to June 2011.

Room rate improvement is finally gathering pace and ahead by 4% against last year, with RevPAR recording 9% growth for the June quarter and 8% for the last 12 months, finishing at \$143 for the year ending June 2011.

Demand growth is not as strong as in Sydney, however, and below our expectations, causing us to revise our occupancy forecast for year-end 2011 from 81.7% to 80.1% with a room rate of \$182, down from \$184. RevPAR for year end 2011 should thus come in at \$146 reflecting growth of just over 5% over 2010.

The outlook for 2012 should see further occupancy growth as new supply is being absorbed, along with stronger rate growth of up to 7.5%. Our updated projections for 2012 are for 81.4% room occupancy at a room rate of \$196, with RevPAR growing by 9.5% to \$159.

Brisbane



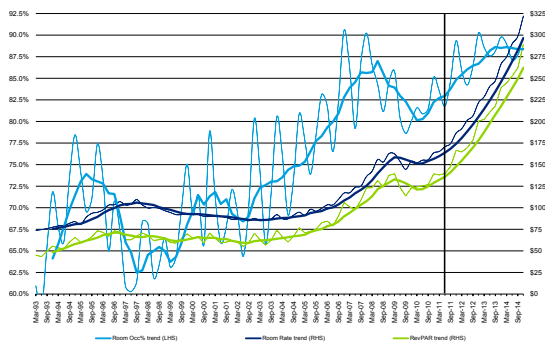
Queensland was hit hard by floods and cyclone Yasi, though the media coverage probably did more damage to the industry than these events themselves. Then again, following disaster comes rebuilding and as Brisbane is the State's headquarters, the brief period of distress was followed by intense activity, which is good news for hoteliers.

Whilst the March quarter occupancy was down 1.3% on the previous year, the June quarter recorded 0.6% growth to 78.5% with a very strong outlook for the remaining two quarters of 2011, finishing the year at 79.6%, up 0.8% on 2010. The forecast for 2012 is for more growth, with room occupancies reaching 82.7% by year-end 2012.

Room rates are following suit, growing around 8% in the June quarter and up 7% for the year ending June 2011, expected to finish at \$173 for the year-end 2011, up \$1 from our previous forecast.

RevPAR for 2011 is now expected to finish at \$137, up 8.7% on 2010. Longer term, RevPAR for 2012 could finish a further 15% up at \$157, based on another 3% in occupancy and an additional \$17 in room rate.

Perth

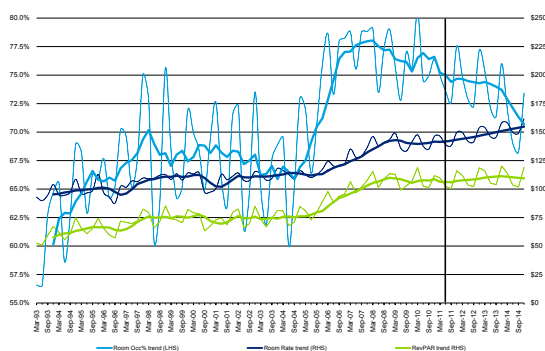


With Australian domestic travel trends decreasing and international travel deterred by rising strength of the Australian dollar, hotel demand in Perth is now relying heavily on business travel. Leisure demand is down, causing issues for hoteliers to achieve higher occupancy levels over non-corporate periods.

Although June quarter RevPAR growth on the previous year achieved 11.2%, signs of diminishing occupancy levels have caused our forward estimates to be revised downwards. June quarter RevPAR growth was achieved almost entirely through rate, with rates increasing 10% on 2010 to \$171. Occupancy growth did not quite reach 1%. The RevPAR forecast for year end 2011 has been revised downwards from \$149 to \$148, as a result of anticipated occupancies decreasing from 86% to 85%. Average rates expectations remain unchanged at \$174.

Forecasts for 2012 have been reduced also, with RevPAR growth rates down from 23% to 20%. This decrease is again caused by slower occupancy growth, with rate forecasts maintaining at \$206 and occupancy forecasts down from 89% to 87%.

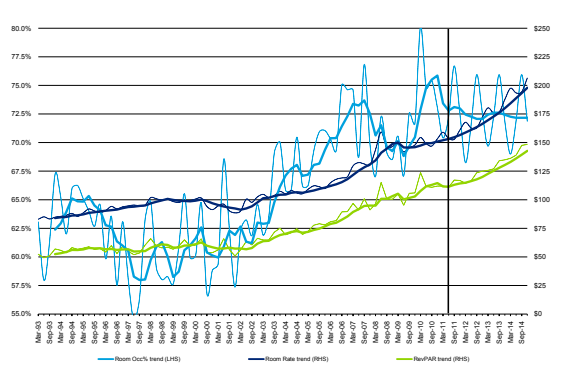
Adelaide



The Adelaide market continues to trend downward, with small increases in rate not capable of compensating for decreases in occupancy. The June 2011 quarter only noted a small decrease of 0.2% on previous year RevPAR, achieving \$102. Year end forecasts have improved, although they remain forecasts of negative growth. Improvements in anticipated occupancy levels have allowed the RevPAR forecast to move from a -3% growth to a -1% growth, with rate maintaining at \$144 and occupancy levels at 75%.

Annual growths in RevPAR are not expected until Q1 of 2012, with year-end 2012 RevPAR growth increasing by 2% from the previous quarter forecasts, reaching \$109 and representing a return to December 2010 results. Occupancy levels are set to reduce by less than 1% to 74% and average room rates to rise by 2% reaching \$147.

Canberra

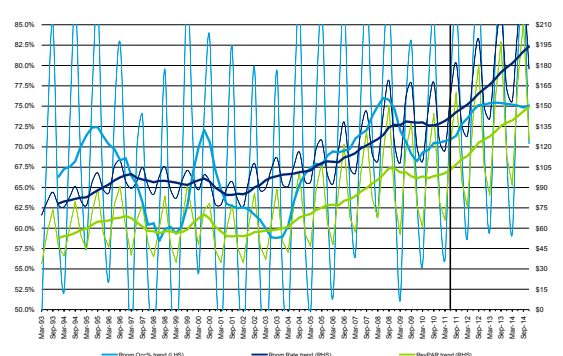


Canberra's outlook for 2011 has been revised downwards yet again as a result of continuing softer than anticipated occupancy results. Occupancy for the June quarter achieved 72.3%, down 2.5% on 2010 results. Average rate however achieved a 3% growth, resulting in quarterly results of \$154. RevPAR achieved \$111 for the quarter end.

Year-end RevPAR forecasts for 2011 have been reduced from our Q2 forecasts of 0.3% growth, to a decrease of 0.2%. Further occupancy decreases anticipated for the September quarter will overshadow all rate growth projected for the remainder of the year, with occupancy set to achieve 73% and average room rate to reach \$156.

Growth is forecast to return for year-end 2012, however at lower levels than previously anticipated. RevPAR is now expected to reach \$120, representing 5% growth but down from 7% growth forecasted in Q2. Average room rates are now forecasted to be \$166 and occupancy levels to achieve 72%.

Darwin



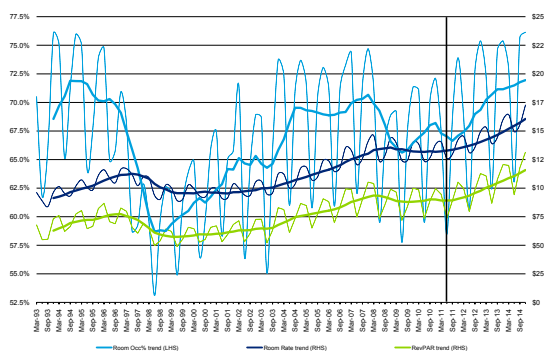
The Darwin market continues to prosper, with no new supply expected, thus, allowing average room rates to push further upwards.

Average room rate reached \$159, growing 8% in the June quarter in comparison to the same quarter in the previous year. Occupancy increased by 0.9% to 77.4%, resulting in RevPAR of \$123, growth of 9.3% on the previous June quarter.

Improvements in the June quarter and the outlook for the remainder of 2011 have allowed increases in forecasts for 2011 year end results. Occupancy is forecasted to achieve 72.9%, average room rates of \$152 and RevPAR of \$111, representing 12% growth on 2010 year end results.

Although nominal supply increases are anticipated for the Darwin market in 2012, further growth is anticipated with RevPAR forecast to achieve a further 13% growth on 2011, up to \$125, as a result of occupancy levels of 75% and average room rates of \$167.

Gold Coast

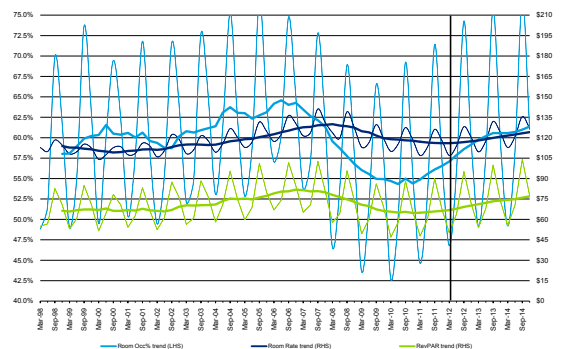


With Peppers Broadbeach opening during the June quarter and further supply increases to come within 2011, uncertainty remains for the Gold Coast market. RevPAR was largely unchanged for the June 2011 quarter in comparison to the previous year, reflecting decreased occupancy of 58.4%, down by 1%, offset by increased average room rates of 2% to \$126.

Given the comforting results for the June quarter, which continues to confirm this market's ability to absorb additional supply, year-end results for 2011 have been revised upwards. Occupancy is now set to achieve 67%, down only 1% and average room rates are set to reach \$135, up 2% from 2010. RevPAR is therefore anticipated to achieve \$91, increasing nearly 1% on 2010.

Further increases in forecast results have been made for 2012 also due to anticipated improvements in domestic and international travel to the region. Occupancy levels are likely to increase by 2% to 69%, average room rates up by 4% to \$141 and RevPAR rates of \$98, representing a growth of 7.7%.

Tropical North Queensland



As a result of natural disasters and diminishing domestic and international tourism to the region, recent forecasts for Tropical North Queensland have been quite grim. Quarterly results for June 2011 however have shown greater strength in demand than anticipated for the region. Although average rates were down 2% to \$113, occupancy was up 2.7% to 53%, allowing a 3.2% growth in RevPAR, which reached nearly \$60.

Forecasts for 2011 year end have now been revised upwards, with growth of 2% in occupancy to 57%, smaller decreases of 1.5% in rate to achieve \$117, resulting in anticipated RevPAR levels of \$66. This represents an annual growth of 2% in a market which we had previously forecasted to decline by 4% growth.

Increases are anticipated across all areas for year-end 2012, with occupancy expected to increase by 3% to 59%, average room rates to increase by 1% to \$119 and RevPAR set to reach \$70, an increase of 6%.

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For the latest insights from Deloitte Tourism, Hospitality & Leisure or for more information about the Deloitte Access Economics Business Outlook – June 2011 please visit www.deloitte.com.au

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