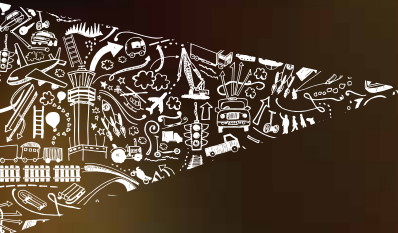


Global hospitality insights

Top thoughts for 2014



EY

Building a better
working world



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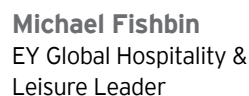
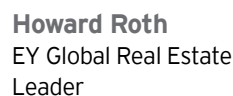
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investors, but a renewed interest in secondary and resort markets is positioned to gain traction in the short term. Cross-border capital flow, led by conglomerates, family businesses and state-owned enterprises in the Middle East and Asia, is also anticipated to increase as international investors seek portfolio diversification and prime assets in stable economies.

The lodging industry will continue to react to an emerging group of guests, including the Millennial generation and a new wave of Chinese tourists, by offering targeted products, services, amenities and designs that cater to generational and cultural preferences.

As both leisure and business travel increases around the globe, destinations must continue to effectively implement their tourism strategy, as well as invest public funds to improve the accessibility of public transportation available to tourists. Furthermore, rich opportunities in developing lodging markets will continue to attract the attention of major lodging players, prompting an increase in international expansion via both acquisition and development.

We are excited to present this year's edition of *Global Hospitality Insights: top thoughts for 2014*. The report reveals key issues and trends we believe will be the primary areas of focus in the global hospitality industry in the upcoming year.





Activity and acceleration in the capital markets

Despite pockets of economic and political uncertainty around the world, the global real estate capital markets are active and accelerating overall. The tailwinds of job growth and rising corporate earnings are becoming stronger than the headwinds of overall unemployment, rising interest rates, and government regulation and fiscal policy. Barring any large, sudden global economic events, the momentum gained in 2013 should lead to improved real estate fundamentals. As a result, markets will be awash in both equity and debt, which in turn should further accelerate transaction volume, along with increased competition.

Regional performance was strong throughout the Americas, notably the US, Canada and Latin America. In the US, year-to-date hotel sales through the third quarter of 2013 remain 49% ahead of the prior year, largely driven by trades of full-service properties. Capitalization rates have remained stable despite a spike in interest rates, averaging 7.7% for full-service properties.¹ Recently, an increasing investor appetite for select-service hotels has emerged, given lower purchase prices coupled with higher operating margins associated with the select-service segmentation.

Relative to other nations worldwide, Canada fared better than most during the recent recession; as such, it saw modest growth in operating performance relative to the larger gains seen in more affected markets. Hotel transaction activity in Canada is expected to be relatively quiet for 2014, with “fair”

opinions of investment and development prospects for full and limited service hotels, and “modestly poor” prospects for development.²

In Latin America, the hotel market outlook is positive in most countries, driven by strong economic fundamentals resulting in strong revenue per available room (RevPAR) expectations. Latin America's real estate transaction activity is anticipated to be led by Mexico and Peru over the next two years. In Peru, specifically, expected economic growth of 5.8% for 2013, as well as Standard & Poor's upgrade of the country's long-term local and foreign currency ratings, has made it an attractive option for hotel investment.³ In Latin America overall, the trend toward secondary markets continues as sentiment remains positive for large secondary cities and tertiary markets, illustrating tremendous potential for the expansion of branded limited service hotels.⁴

1. *US Capital Trends – Hotels*, Real Capital Analytics, 3rd Quarter 2013.

2. *Emerging Trends in Real Estate 2014*, PwC and Urban Land Institute, October 2013.

3. *Hotel Investor Sentiment Survey – Latin America*, Jones Lang LaSalle, September 2013.

4. *Hotel Investor Sentiment Survey – Latin America*, Jones Lang LaSalle, September 2013.



In Europe, the Middle East and Africa (EMEA), the UK remains the most liquid regional market, with London leading the way and continuing to be a magnet for foreign capital (57% of total UK investment volume in 2012).⁵ Similar to the rest of the globe, there has been increased interest in secondary markets in Europe, with the number of active buyers expanding by 16% over the past year. Europe as a whole has seen hotel transactions increase 28% to US\$10.7 million year-to-date through the third quarter of 2013 compared to the same period last year.⁶ In South Africa, real estate investment trust (REIT) activity is expected to increase given the legislation introduced last year to bring REIT structures in line with international standards; that legislations could position the nation as the world's eighth-largest REIT market.⁷

In the Asia-Pacific region, year-to-date hotel transactions have decreased approximately 11% compared to the same period last year, but they represented a 62% increase over prior year levels for the third quarter.⁸ Comparing the first half of 2013 to the same period in the prior year, price per key increased in the region by approximately 23.8% to US\$295,300 due to rising activity in both leisure and business travel. The region also witnessed a renewed

interest in secondary markets, as some investors have indicated concern that key cities such as Hong Kong and Singapore have reached a peak in the investment cycle and that superior returns can be earned elsewhere in the region. However, it should be noted that gateway cities still dominate trades in the Asia-Pacific region, where the top 10 cities in the market account for 60% of deal flow. Similar to South Africa, the Asia-Pacific region has observed a steady increase in REIT issuance; during the first half of 2013, REITs accounted for 25% of the total capital invested in the region.⁹

Globally, select key themes are anticipated to continue into 2014. For example, an increase of capital seeking yield in select-service properties and a renewed interest in secondary markets are anticipated to gain traction in the short term.¹⁰ Momentum from the aforementioned trends were evidenced in 2013, given the surge in transactions in Mexico observed in the Americas; Spain, Poland, Portugal and Ireland for the EMEA region; as well as heightened investor activity in developing Asian markets, including Malaysia and Vietnam in the Asia-Pacific region.¹¹ Despite some regional variances, a positive outlook and favorable transaction climate are anticipated in 2014 for the global lodging industry.

5. *Hotel Investment Highlights – EMEA*, Jones Lang LaSalle, February 2013.

6. *Europe Capital Trends*, Real Capital Analytics, 3rd Quarter 2013.

7. *The Travel Issue*, CBRE Research, July 8, 2013.

8. *Global Capital Trends*, Real Capital Analytics, 3rd Quarter 2013.

9. *Hotel Investment Highlights – Asia Pacific*, Jones Lang LaSalle, August 2013.

10. *Emerging Trends in Real Estate 2014*, PwC and Urban Land Institute, October 2013.

11. *Global Capital Trends*, Real Capital Analytics, 3rd Quarter 2013.



Millennial travel preferences

Self-assured, optimistic, globally connected and curious – the Millennials are poised to take the hospitality market by storm. A Millennial, also referred to as Generation Y or Gen Y, is anyone born between 1980 and 2000. In the US, this group makes up roughly 79 million people.

With their oldest members only 33 years old, approximately 20% of the Millennials are just entering their peak spending ages, and 40% have yet to enter the full-time workforce.¹² Nevertheless, this customer segment is already accounting for around one-third of all business travel expenses.¹³ In the next four years, the Millennials are projected to account for 50% of all employees worldwide. In the next 5 to 10 years, as Millennials enter their peak earning years, this generation will provide the majority of spending for travel and leisure.¹⁴

Millennials in the US grew up during a time characterized by rapid technological advancement and relative affluence created by their parents, the Baby Boomer generation. These circumstances fueled the development of viewpoints, beliefs and

desires different from previous generations, offering opportunities to attract Millennials with a new breed of lodging experiences. In order to cater to this generation with experiences and innovative products that meet or exceed their expectations – both in lodging as well as other industries – it is key to understand some of the following fundamental characteristics and personas that differentiate Millennial customers from their predecessors:

Speed demon. Millennials demand instant gratification, including speed, efficiency and convenience. In fact, fast service is so important to Millennials that it trumps the importance of face-to-face contact or friendly service.¹⁵ This trend has led to the increasing popularity of check-in kiosks at hotels as an alternative to the front desk.

Persistent autobiographer. Many millennials document their life experiences through social media, focusing on primarily funny, unique, inspiring or artistic content

12. "The Millennial Consumer: Debunking Stereotypes," *Boston Consulting Group website*, https://www.bcgperspectives.com/content/articles/consumer_insight_marketing_millennial_consumer/, accessed 22 October 2013.

13. "Traveling with Millennials," *Boston Consulting Group website*, https://www.bcgperspectives.com/content/articles/transportation_travel_tourism_consumer_insight_traveling_with_millennials/, accessed 28 October 2013.

14. "Millennials and Baby Boomers: At Odds or Peas in a Pod?," *Forbes website*, <http://www.forbes.com/sites/meghancasserty/2012/01/19/millennial-and-baby-boomers-at-odds-or-peas-in-a-pod>, accessed 24 October 2013.

15. "The Millennial Consumer: Debunking Stereotypes," *Boston Consulting Group website*, https://www.bcgperspectives.com/content/articles/consumer_insight_marketing_millennial_consumer/, accessed 22 October 2013.



that can stir a response from their friends and followers.¹⁶ This presents a huge opportunity for hotels with a flair for providing interesting products and experiences to receive free, targeted peer-to-peer marketing in return.

Undercover critic. Due to websites and mobile device applications such as Tripadvisor and Yelp, hotels are under more scrutiny than ever to deliver their best service 24/7. When faced with an issue during their stay, Millennials are less likely to complain in person and more likely to post critical feedback online.¹⁷ Furthermore, they are also more likely to research a hotel online through crowd-sourced review sites and social media before booking a stay. In order to capitalize on such real-time feedback, major hotel companies continue to shift their customer care focus to online media so they can express appreciation, respond to complaints, offer ways to help the customer and mitigate damage to their reputation.

Cause activist. According to a recent study by PGAV Destinations, 77% of Millennial travelers believe it is imperative to address causes that are important to them.¹⁸ They like the idea that their money is not just spent for their own enjoyment, but is also going toward a program that helps make the world a better place.

Social being. Although Millennials place less importance on face-to-face contact than prior generations, they have a strong desire to be actively social, including via telecommunication and social media. This hybrid of simultaneous social interaction in both physical space (sharing) and virtual space (communication) describes a phenomenon of isolated togetherness. Millennials' desire for isolated togetherness has become an important consideration for the design of hotels' public spaces, such as lobby, lounges and restaurants.¹⁹

Curious explorer. Whether traveling for leisure or business, Millennials are curious about the local culture and will seek experiences that help them understand foreign customs. In order to respond to this increasing demand for unique, local experiences, global lodging companies have launched boutique, Millennial-focused hotel brands that advertise their ability at "evoking individual tastes and culture from their communities into their architecture and cuisine."²⁰

Spontaneous decision-maker. Growing up with smartphones and constant access to the internet in their hands, Millennials are very comfortable with last-minute decision-making. Mobile device applications that promote last-minute, local hotel bookings on the day of the stay cater to these spontaneous decision-makers and are realizing growing success. Capturing demand through last-minute sales channels is anticipated to increase in importance over the next few years.

Smart spender. With access to more information – but tighter wallets – Millennials are pickier about consuming and spending. In order to address the smart spender, hotels need to become the smart operator and invest their funds into places that will attract the customer. Today's hotels catering to Millennials often focus on offering affordable price points and free amenities, such as Wi-Fi,

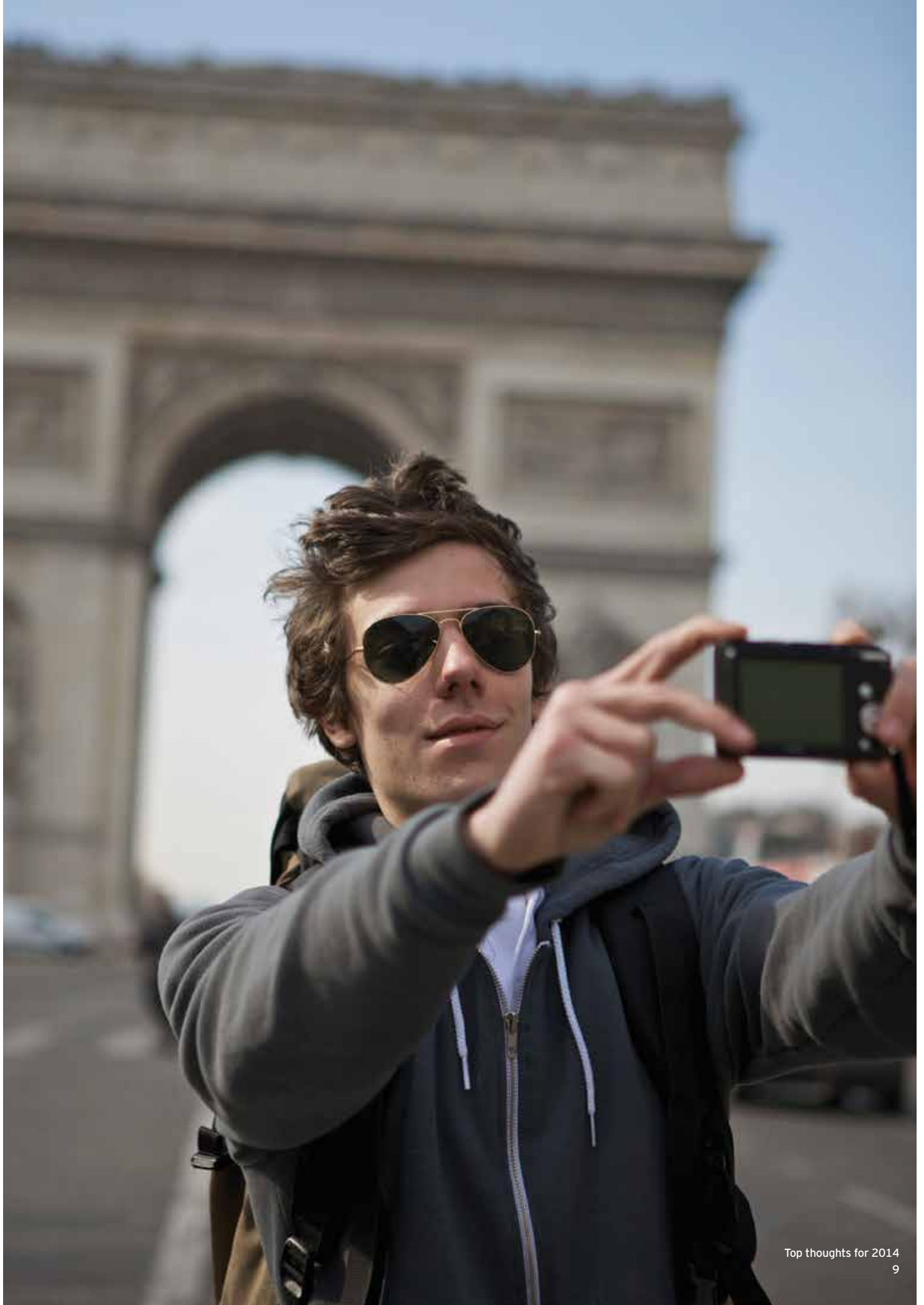
16. "US Travel Trends 2013," *Hotel Price Index website*, <http://www.hotel-price-index.com/2013/fall/travel-trend-predictions/index.html>, accessed 23 October 2013.

17. "The Millennials Check In," *The New York Times website*, http://www.nytimes.com/2012/03/13/business/young-travelers-drive-changes-in-hotel-industry.html?_r=3&scp=1&sq=millennials&st=cse&, accessed 22 October 2013.

18. "Meet the Millennials: Insights for Destinations," *PGAV Destinations*, http://www.pgavdestinations.com/images/insights/Meet_the_Millennials.pdf, accessed 23 October 2013.

19. "The Millennials Check In," *The New York Times website*, http://www.nytimes.com/2012/03/13/business/young-travelers-drive-changes-in-hotel-industry.html?_r=3&scp=1&sq=millennials&st=cse&, accessed 22 October 2013.

20. Hotel Indigo, *IHG website*, <http://www.ihg.com/hotelindigo/hotels/us/en/reservation>, accessed 25 October 2013.





The rise of select service

As the global economy and tourism recovery gains momentum, many travelers continue to show a recession-era preference for select-service hotels that offer a compelling value proposition by providing many full-service amenities at a lower price point. The convenience of select-service also fits the “on-the-go” lifestyle of today’s business traveler and the fast-growing Millennial population.

Select-service hotels are comparable to limited-service properties, but offer some amenities traditionally associated with full-service hotels, such as meeting space or casual dining outlets. Select-service hotels are also increasingly favored by hotel investors and developers due to the lower up-front cost of capital and increased operating margins typical of the segment. Despite the appeal of select service, however, the potential for increased volatility in select-service profits and oversupply of new rooms in some markets may temper the segment’s anticipated strong growth in coming years.

Although select-service hotels are not new, hoteliers rediscovered their benefits during the recent period of economic uncertainty. For investors and developers, select-service hotels are attractive because in many markets around the globe, select service is frequently the only new hotel construction able to secure debt financing in constrained capital environments. The construction

of select-service hotels is also typically faster and more cost-effective than that of full-service hotels, allowing investors to quickly respond to improving hotel market conditions. According to Smith Travel Research, as of late 2012, approximately half of the units in the pipeline in Asia and more than 80% in the US are select-service.²²

Select-service hotels are also more efficient to operate than full-service properties due to limited food, beverage and even space offerings, as well as the absence of a concierge and other services. By limiting service offerings, select-service properties are able to reduce overhead costs, especially payroll. Given the higher operational efficiencies achieved, select-service hotels typically achieve significantly higher margins as a percentage of gross operating profit than that commanded by full-service hotels.²³

22. “Select Your Profits,” *Trends in the Hotel Industry*, PKF Consulting USA, February 2013; “Budget hotel sector finds momentum in Asia,” *Hotel News Now*, www.hotelnewsnow.com/Article/9177, accessed 6 November 2013.

23. “Select Service Hotels,” Moody National REIT Inc., www.moodynationalreit.com/docs/2013-MN-Fact-Sheet.pdf, accessed 25 November 2013.



As investors gravitate toward select service, hotel investors and operators are rethinking mainstay full-service amenities that have characterized the hotel guest experience for years. For example, several major select-service operators have initiated an à la carte payment approach to room service, gym usage and concierge services. One select-service brand in Germany recently rolled out a new pricing structure based on a low-priced room rate with additional services such as gym and pool available on a “pay-as-you-use” basis. From check-in automation to digital lobby signage to guestroom design, select-service brands are also expanding the use of technology to simplify the hotel experience for the “connected” traveler.²⁴

Hotel owners are also re-evaluating underperforming full-service hotels as candidates for conversion to select service. In the US, one New York City full-service hotel recently replaced formal dining outlets with a quick-service food market geared for business and leisure travelers. Other hoteliers have eliminated room service food and beverage operations entirely, choosing instead to outsource room service to local area restaurants.²⁵

Several major hotel brands also are achieving the improved operating efficiencies of select service through the bifurcation of a single hotel into different brands, often pairing an extended-stay format with limited or select service. In a dual-branded hotel, the separately branded hotels share meeting rooms, exercise facilities, back-office operations and even front desks, thereby reducing fixed costs.²⁶ Nevertheless, dual-branded hotels can present operational and workforce challenges due to shared staff providing varied service levels for each respective brand.

Despite the advantages of select service, a recent multi-year comparison of select- and full-service hotels in the US indicated that select-service hotels may operate with more year-over-year volatility in net operating income.²⁷ The segment’s increasing reliance on corporate travel may also contribute to larger decreases in profits, compared to full-service hotels, during periods of slow economic growth.²⁸ The fast, cost-efficient construction of select-service hotels could also lead to short-term oversupply in growing markets such as China and India.

The rise of select-service hotels is indicative of the shifting preferences of travelers and hoteliers. Due to the segment’s higher operating margins and decreased construction costs, select service is expected to remain favored by hotel investors and developers seeking a hotel product that addresses the value and convenience preferences of today’s traveler.

24. “10 trends in hotel technology,” *Hotel News Now*, www.hotelnewsnow.com/Article/10764/10-trends-in-hotel-technology), accessed 28 June 2013.

25. Jacob Tomsky, “Room Service, Please,” *The New York Times*, 9 June 2013.

26. Amy Zipkin, “Seeing Double on Check-In at Certain Hotels,” *The New York Times*, 8 July 2013.

27. “Select Your Profits,” *Trends in the Hotel Industry*, PKF Consulting USA, February 2013.

28. “Select Your Profits,” *Trends in the Hotel Industry*, PKF Consulting USA, February 2013.



Global tax considerations

As investors refine their strategy for 2014, major lodging players must continually evaluate international tax considerations. Around the globe, several key tax trends are anticipated to remain top of mind for hospitality executives in the coming year, including the continued separation of “Opco-Propco” entity structures, increased cross-border capital flows, global tax compliance and transfer pricing, and a heightened focus on indirect taxes.

One trend continually gaining traction is the separation of entities into Opco-Propco structures. Though this trend extends well beyond the lodging sector, its impact has been – and will continue to be – a prominent pursuit driver for hospitality-related tax issues. Opco-Propco structures involve separating the real estate assets into one company and operating assets into another. The structure allows for organizations to identify and focus on one core business, namely owning and operating lodging facilities, or maximizing the values of brands and other intellectual properties. Many Opco-Propco structures use a REIT to serve as the Propco; the Propco will then lease the property to the Opco, which operates the lodging asset. The lease structure of the Opco often includes both a fixed base component as well as a contingent or participating rent component based on the gross revenues of the Opco. Another form of the Opco-Propco structure gaining traction is a paired-share structure for public hospitality companies. The new version

staples a minority position in a Propco REIT with the common stock of an Opco corporation, thus obtaining certain benefits of a REIT structure while retaining a bundled equity position for shareholders.

Significant tax planning and analysis are necessary to form a tax-efficient Opco-Propco structure. The creation of an Opco-Propco structure is often accomplished through a spin-off of one company to the shareholders of the previously combined enterprise, initially creating two “brother-sister” companies. Over time, the overlapping ownership subsides, as the Opcos and Propcos attract dedicated investors into one company or the other. Before creating the Opco-Propco structure, executives must evaluate if the spin-off entity qualifies for tax-exempt treatment, or whether the creation of the Opco-Propco structure qualifies as a taxable transaction for the company and, in turn, the shareholders. A thorough analysis of potential taxable gains, as well as of indirect



taxes such as transfer and property taxes, is necessary to make an informed decision about the optimal steps to convert to an Opco-Propco structure.

In the upcoming years, significant cross-border capital flows will continue to draw focus from a tax standpoint in the hospitality industry. As both investors and operators move into new markets and develop new alliances and joint ventures, tax advisors can no longer focus on just one tax regime when structuring hospitality investments and operations. Instead, advisors must evaluate the tax rule where the capital originates, where it is invested and where it is deployed. Specifically, an extensive analysis of applicable cross-border withholding rates and tax treaties must be evaluated; this is often accomplished as a part of the development of a robust tax model that details the capital flows and corresponding tax consequences over the entire investment cycle. Around the world, countries are regularly revising and updating applicable tax laws to reflect global capital flows and remain competitive; as such, tax advisors must continually review the investment structures being used, as those that may have been optimal in the recent past may no longer be the most tax-efficient structure to deploy.

In the upcoming year, lodging investors must also heighten their focus on worldwide tax compliance and transfer pricing. Global tax enforcement continues to evolve and improve, causing hospitality

companies to use electronic platforms to track global tax compliance and controversy projects. In the absence of such tracking tools, companies may encounter challenges properly identifying and monitoring global tax risks, and they may face further difficulty in proactively manage them. A best practice among leading hospitality players is to maintain a real-time dashboard that monitors global tax filings and alerts them to upcoming filing deadlines and other critical tax milestones.

In addition, many hospitality investors have increased their focus on transfer pricing, both globally and domestically. Companies must confirm that the transfer pricing of their intercompany transactions and cost allocations is compliant with relevant tax regimes, as well as reflects the current operational state. As new business processes continue to evolve, transfer pricing analyses must be updated continually; they are not a one-time exercise that can be performed periodically.

Lastly, hospitality players in 2014 will continue to face an increased focus on indirect taxes such as transfer taxes, property taxes and value-added taxes. Continued financial pressures on governments across the globe have led to the introduction or expansion of unprecedented indirect tax burdens. Tax advisors have found that even intercompany transactions may generate unexpected tax liabilities, and new indirect "change of control" transfer taxes can cause tax burdens resulting from subtle ownership changes at the parent company level. Overall, as major lodging players reconfigure their investment strategy for 2014, one must carefully consider the resulting tax consequences before taking action.



China travel trends

China's outbound tourism industry has grown exponentially in recent years, as discretionary income levels among the rising middle class have increased, visa policies around the world have eased and the proliferation of information on outbound travel has heightened the desire to travel abroad. Data from the National Bureau of Statistics of China indicated that outbound travel increased at a compound annual growth rate of 18.5% between 2000 and 2010, from approximately 10.5 million to 57.4 million travelers, respectively.²⁹

The surge in travel from China, propelled by increased discretionary income and relaxed visa restrictions from popular tourist destinations, is anticipated to further increase in 2014 and beyond.

As a result of steady economic growth in the country, the burgeoning middle class in China has recorded continuous increases in disposable income levels, making overseas travel possible for a larger percentage of the population. While only 4% of urban Chinese households were classified as middle class in 2000, that percentage quickly rose to 66% in 2012 with the rapid expansion of the Chinese economy.³⁰ Chinese tourists, particularly middle-class travelers, prefer to travel abroad rather than domestically, as they increasingly view such trips as a form of reward for their hard work during the year.³¹ In 2012, international travel from China reached a new peak, with an estimated 83 million residents traveling outside of the mainland, representing a

20% increase over the previous year.³² Heightened tourism from China is not only observed in the increased number of travelers, but also in the larger amounts of money spent while traveling abroad. In 2012, Chinese tourists overtook the US and Germany as the world's largest spenders, spending more than US\$102 billion in 2012, a 40% increase from 2011.³³

The lift in visa restrictions has also helped drive the surge in tourism from China. Historically, Chinese travelers faced stringent visa restrictions from select countries, including the US, Australia and France; until recently, international Chinese travelers were limited to travel within regions with less restrictive visa policies, most notably other Asian countries. However, in 2012, the U.S. State and Homeland Security departments agreed to increase the number of non-immigrant visas issued to Chinese citizens by 40%. Other countries, such as Australia, Germany and

29. *The 21st Century Game-Changer Up Close – China Outbound Tourism*, HVS, April 2011.

30. "China's Middle Class Is Fueling A Boom In This Overlooked Sector," *Yahoo! Finance*, 23 July 2013, <http://finance.yahoo.com/news/chinas-middle-class-fueling-boom-133000919.html>, accessed 2 November 2013.

31. *Global Reach of China Luxury*, KPMG, January 2013.

32. "Why Chinese Outbound Tourism Is a Good Bet," *The Wall Street Journal*, 18 October 2013, <http://blogs.wsj.com/chinarealtime/2013/10/18/video-why-chinese-outbound-tourism-is-a-good-bet/>, accessed 2 November 2013.

33. "Chinese travelers the world's biggest spenders," *CNN Travel*, 12 April 2013, www.cnn.com/2013/04/05/travel/china-tourists-spend/, accessed 2 November 2013.



Global hoteliers have observed a recent shift in preference of Chinese tourists from guided tours to more self-organized travel, leading to changes in travel needs and behavior. Historically, regions with limited Mandarin-speaking guided tours experienced less travel activity compared to overall demand, such as France. However, the aforementioned countries have witnessed increased travel activity with the emergence of “new Chinese tourists” – travel-savvy, well-educated Chinese travelers, predominantly under 45 years old.³⁷ The recent shift in preference provides opportunities for Chinese tourists to visit less-traveled destinations.

Additionally, both domestic and international hotel investors have reacted to growing tourism from China by offering Chinese-targeted lodging products and special programs. In addition to launching China-focused lodging brands, major lodging companies have introduced cultural training programs for hotel staff, such as Mandarin-speaking courses. Hotels catering to Chinese tourists are also offering preferred in-room amenities, including slippers and Chinese tea. Select international hotel companies have introduced preferred payment options and entertainment selections (e.g., literature, TV programs and newspapers) translated into Mandarin.³⁸

In light of expected continued economic development in China, outbound tourism from China is likely to grow over the next few years. Meanwhile, disposable income levels within China are expected to continue to increase, leading more consumers to choose overseas destinations for their travel plans. With an estimated 200 million Chinese residents expected to travel outside the mainland by 2020, growth in Chinese outbound tourism is expected to remain strong in years to come.

Spain, have implemented similar programs to attract more Chinese travelers by easing visa requirements or extending the length of multiple-entry visitor visas.³⁴ Aside from travel into previously restricted regions, international Chinese travel has also surged within neighboring locations. Within Asia, destinations such as Hong Kong, Macau and Thailand remain popular among Chinese travelers, given their accessibility, shopping and gambling attractions. South Korea has also experienced a recent increase in Chinese visitors with growing interests in the Korean Wave (“Hallyu”) and K-pop culture.³⁵

Increased travel has caught the attention of the international lodging community, prompting changes to adapt to the customs and preferences of the Chinese guest. According to the *Chinese International Travel Monitor*, 96% of Chinese tourists surveyed have traveled abroad for leisure, while 52% visited other countries for business or educational purposes. Regarding hotel choice, more than half of Chinese travelers choose a 3- or 4-star hotel as comfort, star-rating and facilities are the most important factors when selecting accommodations.³⁶

34. “Obama eases visa rules to boost U.S. tourism,” *USA Today Travel*, 1 January 2012, <http://travel.usatoday.com/news/story/2012-01-18/Obama-expected-to-shorten-tourist-visa-process/52652668/1>, accessed 2 November 2013.

35. “Chinese Tourism Tastes Are Changing, and Here’s Why,” *The Wall Street Journal*, 25 September 2013, <http://blogs.wsj.com/chinarealtime/2013/09/25/chinese-tourists-travel-farther-southeast-asi/>, accessed 3 November 2013.

36. *Chinese International Travel Monitor 2013*, Hotels.com, August 2013.

37. *Hospitality for Chinese Guests*, Hotel Association of Canada, September 2013.

38. “Hilton Welcomes Chinese Travelers at Home and Abroad,” *China Business Review*, 1 January 2012, www.chinabusinessreview.com/hilton-welcomes-chinese-travelers-at-home-and-abroad/, accessed 3 November 2013.



Renewed interest in all-inclusive offerings

In recent years, major lodging players have signaled a renewed interest in the all-inclusive (AIR) industry. While AIR resorts traditionally offered a cost-centric product for budget-conscious vacationers, today's offerings encompass more upscale products as the industry targets those looking for a refined, experiential vacation that better reflects their perceived positioning and self-worth.

Fueling this change in mindset is a shift in the global population, changes in government policies and the advancement of technology. These factors are turning once-remote locations into feasible destinations for those seeking adventure and isolation.³⁹ The AIRS industry – especially family-friendly lodging alternatives – is also benefiting from the economic rise of collectivist countries, such as Brazil and China, which has prompted a growth in the number of families traveling.⁴⁰ Overall, the changes in leisure travel preferences and the rise of emerging markets has resulted in bookings for AIRS resorts increasing at a much higher rate than the industry average.⁴¹

As leisure travelers' demands have evolved, growing competition among the AIRS operators has spurred a quest for product differentiation, resulting in the emergence of brands targeting specific customer types

(e.g., singles, couples, families, health conscious, sustainability focused). With the demand for more upscale offerings, the luxury AIRS resort has been established to provide higher quality food and entertainment, along with a greater variety of amenities and services (e.g., spas, casinos, water sports). The most noticeable improvement undertaken at AIRS resorts is the high quality of food and beverage offerings. The buffet lines of the past have been replaced with high-end restaurants that emphasize regional cuisines, locally sourced ingredients and sustainability, factors that appeal to the property's sophisticated, socially conscious clientele. Additionally, basic liquor offerings are now replaced with upscale bars offering premium liquors and, in some cases, lounges with specialty cocktails. AIRS resorts have further revamped their activities programs, focusing on off-site excursions that feature outdoor adventure activities such as zip-lining, scuba diving, and hiking and exploring rainforests.

39. "Ten resort trends," ULI, September 2013.

40. Ibid.

41. Joanna Booth, "All-inclusive resorts: what's new for 2009," *Travel Weekly*, 14 August 2008.



These vast changes in the AIRS industry are due to several socio-economic forces beginning to ripple through major source markets. The heightened affluence among high-income groups and a growing global wealth base has jumpstarted an expansion in the luxury resort market.⁴² Additionally, the discretionary income spending habits of Millennials, which is more aspirational and significantly higher than the spending habits of previous generations, is further fueling the demand for upscale and luxury leisure travel. Though they are more frugal, collectively Millennials are outspending other groups. Furthermore, the rising middle-class citizens from developing countries, who place a strong emphasis on family, exploration and budget, are increasingly attracted to the AIRS model, fueling a renewed interest in these resorts across the globe.

The AIRS industry has continued to refine itself over the past decade, as parent brands with AIRS resort properties at different positioning and price points have continued to develop. These parent brands benefit from operational efficiencies and product diversification by operating multiple resorts at various classes. The rising attractiveness of AIRS properties has caught the attention of global players, as major traditional US and European lodging brands have expanded into the AIRS market via both acquisitions of existing companies and repositioning of current lodging products. In the Americas, new players have primarily entered the AIRS industry

via acquisition and property conversions, while new entrants in European markets overlap AIRS packages within their existing properties to create a “hybrid” resort that caters to two distinct market segments. The expansion of AIRS into Asia has not yet taken roots as there are little to no supply offerings in most markets.

The location of AIRS hotels often drives the property's success. Most properties find success in remote or tropical locations where there is little competition resulting from demand generators such as major cities. Globally, the majority of AIRS product is now concentrated in mass-market destinations with low labor costs – Mexico, Dominican Republic, Cuba, Jamaica and, to a lesser extent, the Mediterranean basin. In the Mediterranean, the rise of AIRS hotels is focused on existing hotels offering AIRS options as opposed to new development. Such options largely target families, while Millennials and couples are routinely targeted by AIRS hotels.

Given the improved perception of AIRS resorts by both consumers and operators, developers have a strong incentive to create additional AIRS resorts. The positive demand trends, in combination with clear operational efficiencies relative to forecasting revenues, labor costs, and specifically food and beverage costs, strongly indicate that the AIRS market expansion is anticipated to continue. However, AIRS operators will continue to struggle with the model's biggest weakness – the inability to upsell guests and, more specifically, generate additional revenues as guests are typically locked into certain price points. Despite the challenge, the outlook is bright as the AIRS industry continues to evolve and respond to the growing demand for pre-packaged, AIRS experiences.

42. “Ten resort trends,” ULI, September 2013.



Effectively implementing your tourism strategy

For many destinations, tourism sits at the core of the region's economy, acting as an engine for job creation and economic growth. In the years following the global economic recession, tourism destinations are once again evaluating their strategies for promoting visitation, maximizing a renewed interest in both business and leisure travel. To capture the demand of new and repeat travelers, destinations must effectively implement their tourism strategy, as well as support the necessary public infrastructure to ensure the visitation of future travelers.

Across world, tourism enterprises, including economic development corporations, destination marketing organizations (DMOs), convention and visitors bureaus, tourism authorities and direct marketing organizations, are deploying tourism strategies to increase global awareness of their destination. Tourism enterprises today look for private sector leaders, such as senior executives with direct hospitality experience, rather than political appointees to carry out a destination's marketing strategy. Tourism enterprises that seek top talent in the private sector often outperform their public counterparts, given their ability to function free of political interference and familiarity with an incentive- and goals-driven operating model. Additionally, effective tourism enterprises often feature a diverse advisory board that offers strong leadership and governance; advisory boards

of leading DMOs typically feature 7 to 10 members of diverse business backgrounds who can easily adapt a region's tourism strategy to changing economic and demographic trends.

In addition to seeking top, diverse talent and effective governance, tourism authorities have been faced with increased global competition among destinations, prompting them to refocus on the operations of their enterprise. Across the world, leading DMOs have shifted their strategy from being solely a sales and marketing role to one that concentrates and improves upon all aspects of the visitor experience. For example, Bermuda's tourism authority, which is currently transitioning from a public to a private tourism enterprise, seeks to enhance



guarantees and tourism development funds. The PRTC specifically provides investment through three separate entities, including the Hotel Development Corporation, a subsidiary of the PRTC that acts as a participating junior lender or preferred investor. These investment entities have contributed to Puerto Rico becoming a leader in the in terms of hotel construction, with more than 1,100 new hotel rooms in operation or under construction and more than 60 lodging projects in various stages of the development process.⁴⁴

DMOs are further strengthening partnerships with governmental entities responsible for implementing and funding infrastructure development, bridging the private and public sector for operational and investment support. For example, London & Partners, the semiprivate DMO for the city of London, partners with the UK Trade & Investment Corporation to develop programs and initiatives to attract capital investment for infrastructure improvements. These include 24/7 operations for the Tube, London's subway system, providing both tourists and residents non-stop access throughout the city.⁴⁵

Influential tourism enterprises offer visitors consistent experiences from arrival to departure, creating a lasting memory for travelers. When coupled with investment in accessible infrastructure, destinations gain a competitive advantage in a growing, global market for travel.

the visitor experience by allocating funds toward experience development, tourism training and education and niche marketing, helping to create an unforgettable experience for the visitor and increase the likelihood of a return visit.

An additional element of effective tourism implementation lies in public infrastructure investments. Recognizing infrastructure as a catalyst for tourism and lodging development, DMOs have also embraced the development and financing of infrastructure projects as part of their overall strategy. In St. Vincent and the Grenadines, for example, a wholly owned government limited liability company is currently administering the development, construction and financing of an international airport, anticipated to open in 2014, to improve air access and spur tourism and economic growth.⁴³ Other destinations around the world, including Miami, Atlanta and London, have committed to similar large-scale airport and rail projects as a way to improve traveler connections to tourist zones.

In addition to overseeing infrastructure development, DMOs are also playing a direct role in tourism infrastructure investment, securing financing for improvements in local infrastructure to support and enhance the destination experience. Some tourism entities, such as the Puerto Rico Tourism Company (PRTC), provide investment alongside developer and institutional capital via government

44. "2013-14 Business Plan," *London and Partners website*, www.london.gov.uk/sites/default/files/05a%20Appendix%20A%20PDF.pdf, accessed 4 November 2013.

45. "2013 Puerto Rico Credit Conference," *Commonwealth of Puerto Rico – Government Development Bank for Puerto Rico website*, www.gdb-pur.com/PRCC2013/documents/CC2013%20-%20May%2017%202013%20-%20Tourism%20Presentation%20vFINAL.pdf, accessed 4 November 2013.

43. "Project Background," *International Airport Development Company website*, www.svgiadc.com/index.php/development/project-background, accessed 4 November 2013.



Investment in sub-Saharan Africa

Investment in Africa continues to capture the attention of the global lodging community. In recent years, Africa's emergence as a key target market for international hotel investors and operators has affirmed the region, notably sub-Saharan Africa, as a hot spot for development. Over the past year, increased global attention has presented both opportunities and risks in the hotel investment landscape of sub-Saharan Africa.

Currently, approximately 30 sizable hotel groups operate in Africa, representing more than 60 brands. From a geographic standpoint, approximately 47% of existing hotel rooms are in sub-Saharan Africa.⁴⁶ This distribution does not reflect geography, as there are nearly 50 countries in sub-Saharan Africa, while only 5 countries make up Northern Africa. The established tourism destinations on Africa's Northern coast, most notably Morocco and Egypt, have long existed as vacation spots for Europeans, resulting in the current imbalance. In terms of development activity, however, sub-Saharan Africa leads the continent. In 2013, the development pipeline in sub-Saharan Africa increased 23% over the previous year, with about 80 hotels in various stages of development.⁴⁷

Increased investor attention to this region has resulted in some improvements in policymaking and access to financing; however, long-standing risks and barriers to entry continue to pervade in the market. Most notably, poor transportation infrastructure has historically restricted the connectivity of the sub-Saharan region. Air travel remains limited despite investments from nations in airports and/or local airlines, as seen in Kenya and South Africa. Construction is generally expensive compared to other developing global markets, such as the Middle East, mostly due to a costly and unreliable supply of utilities, including electrical power, and key construction materials like as cement. Moreover, the fragmented road infrastructure and a lengthy process for required official documentation (e.g., licenses, customs) have resulted in construction delays. Given the aforementioned challenges, hotel operators and investors entering the market are often advised to collaborate with strong local partners and advisors to mitigate risks.

46. "Hotel chain development pipelines in Africa 2013," *W Hospitality Group website*, www.w-hospitalitygroup.com, accessed 10 October 2013.

47. "Hotel chain development pipelines in Africa 2013," *W Hospitality Group website*, www.w-hospitalitygroup.com, accessed 10 October 2013.



improvements in policy and infrastructure, has signaled confidence to international lodging players about investment in the region. In November 2013, a major hotel brand announced its intention to acquire one of Africa's leading hotel groups, whose assets encompass a portfolio of nearly 120 hotels with more than 10,000 rooms. This acquisition would not only double the brand's footprint in Africa, it would further circumvent market entry barriers and result in gaining a significant competitive advantage on the continent.

While the overall regional outlook remains positive, select countries appear better positioned than others for lodging growth. From a business travel standpoint, Ghana and Nigeria represent current hot spots for hotel investment and development. Ghana's buoyant economy, with annual GDP growth averaging 8.7% between 2008 and 2012,⁵⁰ has been fueled by increased oil production and government efforts to bolster the economy, resulting in an influx of foreign investment. Travel to Ghana has further increased due to extensive public investments in the country's infrastructure, notably in the Kotoka International Airport, located in Ghana's capital of Accra. While growth has been somewhat hampered by current high lodging costs, Ghana ranked third in hotel development in sub-Saharan Africa in 2013, with more than 1,400 hotel rooms under development.⁵¹

Nonetheless, despite certain challenges, sub-Saharan Africa offers significant opportunity for hotel development. From an economic standpoint, the region is well-positioned for growth; due to an abundance of natural resources such as oil, the World Bank has forecasted annual GDP growth in sub-Saharan Africa to increase to 5.5% per year by 2015, up from 4.2% in 2012.⁴⁸ Additionally, sub-Saharan Africa's landscape, which features rich, natural resources and diverse landscapes unique to the region, positions the lodging market to capture both business and leisure demand. Countries across the region have specifically cited travel and tourism as a key pillar for economic growth, and subsequently allocating government funded to promote tourism.

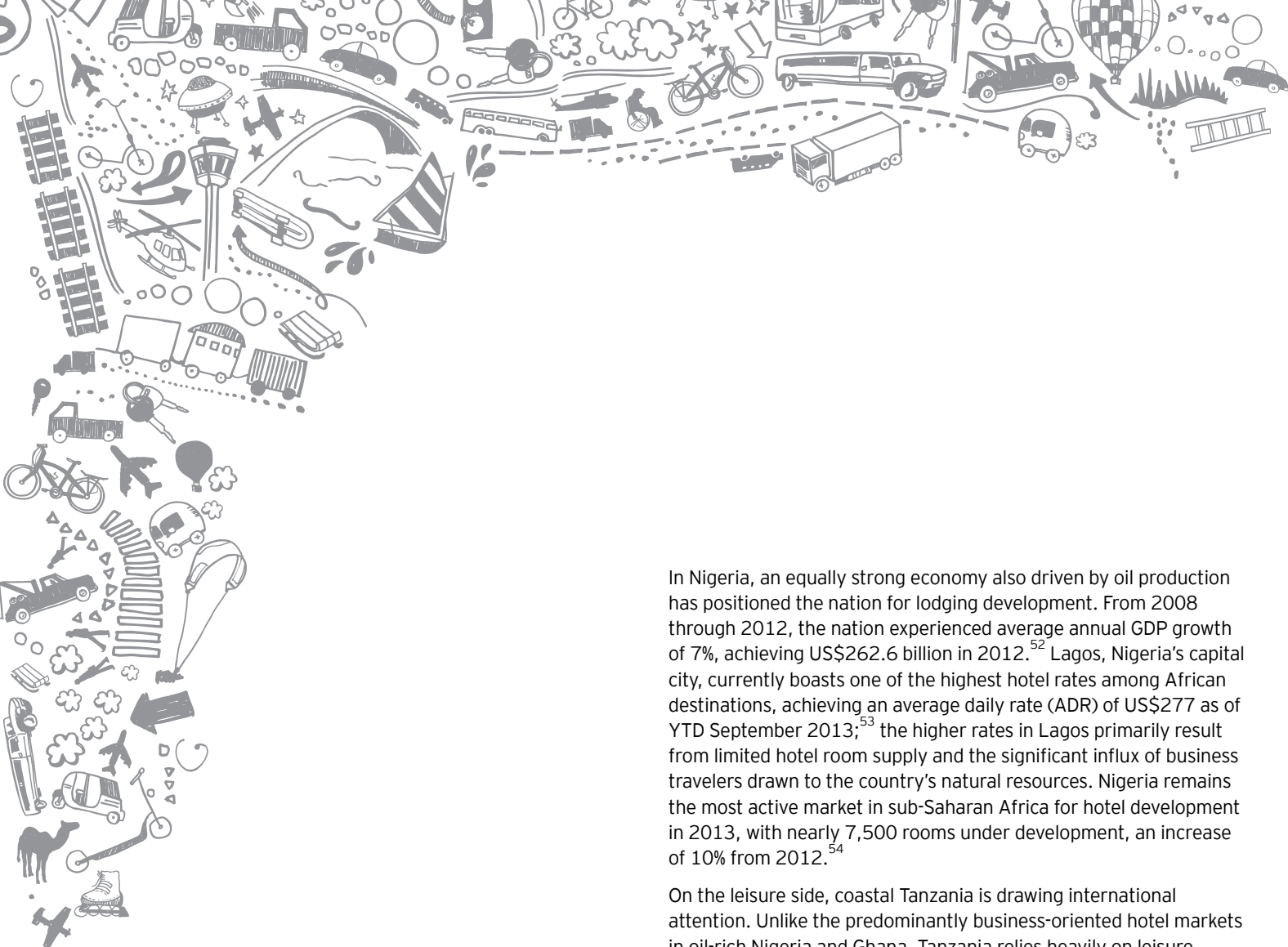
Sub-Saharan Africa's growing economy and internal focus on tourism, coupled with a current undersupply of hotel rooms, have gained the attention of investors around the world. In response to the tremendous opportunity for lodging development, access to financing has eased in the region, in contrast to the stringent regulations and barriers faced in prior years. Over the past year, lodging developments in sub-Saharan Africa have benefited from both international and domestic investment, including African and international pension funds, sovereign wealth funds, African private equity and real estate funds, as well as foreign direct investment from Middle Eastern and Chinese investors.⁴⁹ The increasingly friendly investor climate, coupled with gradual

48. "Africa's ample resources provide an opportunity for inclusive growth," *The World Bank website*, www.worldbank.org, accessed 10 October 2013.

49. "Real estate in Africa: Possibilities for property pioneers," *Webber Wentzel website*, www.webberwentzel.com, accessed 10 October 2013.

50. "Ghana," *The World Bank website*, data.worldbank.org/country/ghana, accessed 10 October 2013.

51. "Hotel chain development pipelines in Africa 2013," *W Hospitality Group website*, www.w-hospitalitygroup.com, accessed 10 October 2013.



In Nigeria, an equally strong economy also driven by oil production has positioned the nation for lodging development. From 2008 through 2012, the nation experienced average annual GDP growth of 7%, achieving US\$262.6 billion in 2012.⁵² Lagos, Nigeria's capital city, currently boasts one of the highest hotel rates among African destinations, achieving an average daily rate (ADR) of US\$277 as of YTD September 2013;⁵³ the higher rates in Lagos primarily result from limited hotel room supply and the significant influx of business travelers drawn to the country's natural resources. Nigeria remains the most active market in sub-Saharan Africa for hotel development in 2013, with nearly 7,500 rooms under development, an increase of 10% from 2012.⁵⁴

On the leisure side, coastal Tanzania is drawing international attention. Unlike the predominantly business-oriented hotel markets in oil-rich Nigeria and Ghana, Tanzania relies heavily on leisure tourists, offering guests pristine beach resorts and extensive nature reserves for safaris. In recent years, government efforts to promote domestic and international tourism to Tanzania have significantly increased, and there has been a concerted effort to attract travelers from emerging markets, particularly China, India and Russia. Given the nation's efforts, a 40% annual increase in total visitors is anticipated in Tanzania in 2013.⁵⁵

Opportunity for investment in Africa exists, but it requires careful planning by the investor. Given the region's improving economic factors, decreased risk through governmental and international investment, and the current undersupply of hotel rooms, investment opportunities in the sub-Saharan African hotel market remain as diverse as they are abundant, with plentiful opportunity in both business and leisure travel.

52. "Nigeria," *The World Bank website*, data.worldbank.org/country/nigeria, accessed 10 October 2013.

53. *Middle East/Africa hotel industry performance*, STR Global, September 2013.

54. "Hotel chain development pipelines in Africa 2013," *W Hospitality Group website*, www.w-hospitalitygroup.com, accessed 10 October 2013.

55. "Tanzania seeks 40 percent more tourists in 2013 – minister," *Reuters*, www.reuters.com/article/2013/11/13/tanzania-tourism-idUSL5N0IY3QK20131113, 13 November 2013.





Alternative lodging products

In decades past, travelers constrained to a tight budget often sought inexpensive alternatives to the traditional hotel. In response to this need, alternative lodging products such as serviced apartments, apartment rentals and hostels emerged to serve these budget-minded guests. However, alternative lodging accommodations no longer cater solely to the cash-strapped traveler; today, they have gained industry recognition as an alternative preferred by guests seeking greater flexibility, convenience and social interaction than is commonly found in a traditional hotel setting.

Serviced apartments and apartment rentals are two alternative lodging products gaining momentum globally. Available for short- or long-term stays, both product types provide temporary, furnished accommodations in a residential setting, offering guests amenities not found at traditional hotels, such as a fully equipped kitchen, workspace and living room. While each option offers comparable amenities, they have one key differentiator: serviced apartments are often designed for rental usage exclusively, whereas apartment rentals are often inhabited by the owner, who in turn offers either a single room or the apartment in its entirety to outside guests.

While these lodging products have been successful in US markets with high rental barriers to entry and significant lodging costs, including New York City and San Francisco, they have historically failed to penetrate major markets in Europe, such as London and Paris, despite these markets sharing similar rental and lodging

characteristics. According to The Apartment Service Worldwide, 62.9% of the world's 656,000 service apartment units are in the US and Canada, while 13% of current supply is located in Europe.⁵⁶ Despite this current geographic imbalance, serviced apartments and apartment rentals are gaining traction globally as travelers continually seek accommodations that contain basic travel necessities, while also offering a sense of personal space in a comfortable atmosphere.

In addition to serviced apartments and apartment rentals, upscale hostels have captured the attention of travelers across the world. Unlike the traditional hotel model, hostels provide shared rooms ranging from 4 to 10 or more people per room, often in a twin-sized, bunk-bed format; this layout allows for the owner to maximize the amount of paying guests without increasing room inventory. In the early 20th century, hostels emerged as a budget-friendly alternative to the traditional hotel, offering

56. *The Global Serviced Apartments Industry Report 2013/2014*, The Apartment Service Worldwide, June 2013.



inexpensive accommodations to young travelers at the expense of decreased amenities. However, modern hostels no longer solely attract the budget-conscious traveler. They also appeal to those seeking an interactive, socially driven lodging experience by offering amenities such as extensive public space, group events, vibrant design and high technological capabilities. Traditionally present in Europe and Asia, hostels today are gaining traction in other global regions among both travelers and institutional investors. In the US, financing for hostel development has materialized in key gateway cities, including Chicago, Los Angeles, New York and Miami.⁵⁷

Two additional and seemingly recessionary-proof alternatives to traditional lodging include the portable hotel and the transit hotel. A portable hotel is a self-contained, “just in time” accommodation that is easily transportable and prefabricated. The portable hotel has emerged in response to major demand generators and can be seen throughout the world near airports, railways, hospitals, offices and other highly trafficked locations. Given their relatively short setup time and transportable nature, portable hotels offer immediate, temporary accommodations in areas lacking traditional hotel accommodations, such as near remote film and TV shoots, music festivals, sporting events, disaster and emergency relief areas and military bases.

The transit hotel is also gaining traction globally. Originating in Asia, notably in and around international airports, transit hotels are micro rooms or nightly rental pods that provide minimally sized accommodations, with most offerings typically under 200 square feet each. In recent years, the concept of transit hotels has expanded outside of major Asian transportation hubs to other major international cities in Europe and the Americas, with recent pod hotels opening in New York City and London. Transit hotels offer guests cheaper rates while simultaneously allowing owners to minimize costs by limiting the amenities offered.

Despite growth in popularity among international travelers, some alternative lodging products present key challenges for the traditional hotel user and lodging investor. From an investor standpoint, alternative lodging products are often viewed more as a temporary fad than a long-term investment. Historically, their quality and services have been perceived as inconsistent by guests, especially in hostels and serviced apartments. As a result, owners have found it difficult to “brand” these segments and have turned to capital investments in renovations or ground-up development to better ensure consistency among properties. Nonetheless, despite certain challenges, the alternative lodging sector offers great potential for development, as the changing desires of travelers, limited lodging supply growth and heightened travel activity continue to drive demand for alternatives to the traditional hotel.

57. “Hostel metrics, development gaining steam,” *Hotel News Now website*, 4 November 2013, www.hotelnewsnow.com/Article/12599/Hostel-metrics-development-gaining-steam, accessed 22 November 2013.



IFRS considerations

As the global lodging industry enters 2014, key issues in assurance and compliance with International Financial Reporting Standards (IFRS) remain top of mind for major hotel players. While a significant portion of key global capital markets jurisdictions have adopted IFRS or endorsed all or a portion of guidelines published by the International Accounting Standards Board (IASB), gaps remain in select markets.

Currently, India, Japan and the US only allow financial reporting under IFRS guidelines on a limited voluntary basis for certain domestic and/or foreign issuers as such jurisdictions continue to evaluate and address various convergence concerns. Further, for those jurisdictions that have adopted the use of IFRS for financial reporting purposes, most only require publicly traded companies to comply with such reporting standards with varying requirements for non-listed entities depending on size, industry and other factors.

However, on an overall basis, despite variations in convergence time frames and scope of adoption, it is evident that the financial community as a whole supports efforts to centralize and create uniformity in financial reporting standards. Specifically, of the 81 jurisdictions profiled by the IFRS Foundation, which includes all G20

jurisdictions, 78 have publicly endorsed the establishment and adoption of uniform international accounting standards on a global basis.⁵⁸

Upon adoption of IFRS, the financial statements of owners and operators of hotels will be required to comply with IFRS 13 *Fair Value Measurement*, which is effective for annual periods beginning on or after 1 January 2013 and establishes a single framework for all fair value measurements, including those related to real estate assets. For those countries or jurisdictions that previously applied International Accounting Standards (IAS) 40 *Investment Property*, IFRS 13 replaces the previous requirements regarding how to measure fair value. The definition of fair value in IFRS 13 is relatively consistent with the market value as defined in International Valuation Standards (IVS). However, entities reporting under the new guidance need

58. "Analysis of the IFRS jurisdictional profiles," *IFRS website*, www.ifrs.org/Use-around-the-world/Pages/Analysis-of-the-IFRS-jurisdictional-profiles.aspx, accessed 24 October 2013.



to be aware of the conceptual differences between IFRS 13 and IVS to ensure any values used for financial reporting purposes that are obtained from appraisals are consistent with the objective of fair value measurement in accordance with IFRS 13.

IFRS 13 defines fair value as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.”⁵⁹ This effectively results in a definition of fair value that reflects an exit price for the respective property in question. Conceptually, the definition of fair value under IFRS 13 differs from IVS in that any transaction advantages or disadvantages that would not be available to market participants generally should be disregarding when measuring fair value for financial reporting purposes, whether revaluing an asset or determining the extent of impairment to be recognized.

Additionally, the concept of “highest and best use” is given much greater focus under IFRS 13. Specifically, under the new requirements, an entity’s current use of an asset is presumed to be its highest and best use, unless other factors suggest that a different use of that asset by market participants would maximize its value. This determination will require considerable judgment on the part of management and will require an understanding of local market dynamics, financial feasibility, and the presence of legal limitations

or restrictions that could affect the conclusion that the property’s highest and best use continues to be its current use.

IFRS 13 continues to permit the three generally accepted approaches to fair value – the market approach, the cost approach and the income approach. However, the standard puts greater emphasis on the selection of inputs, requiring the use of observable inputs over unobservable ones. As such, it is imperative that management analyze appraisals received in order to conclude that such fair values are derived based on the amended definition of fair value. While general concepts and approaches to measuring fair value under IFRS 13 are consistent with those under the majority of local generally accepted accounting principles, careful consideration is required by hotel owners and operators to identify changes to current fair value practice and related changes in disclosure requirements.

As the lodging industry enters 2014, certain implementation issues may arise within hotel organizations across the world. IFRS 13 significantly expands the financial reporting disclosure requirements for fair value measurements, whether recognized or only disclosed. The additional reporting requirements will particularly affect any fair values determined using significant unobservable valuation inputs, which would warrant categorization within Level 3 for financial reporting purposes.

With regards to implementation of the new standard, concerns generally pertain to the accurate consolidation and compilation of the various data points necessary to comply with the enhanced disclosure requirements. Specifically, issues can arise as a result of variations in fair value methodology, key inputs and appropriate levels of aggregation for identified segments. Those entities with significant variations in hotel type or geographic footprint, among other significant considerations, will need to continually evaluate the appropriateness and effectiveness of structure and extent of required disclosures.

59. IFRS 13, Appendix A.



Outbound investment from Asia

In search of capital preservation and diversification of assets by geography, currency and political policies, Asian investors have been a leading force in the hospitality industry. Cross-border capital accounted for 33.8% of global hotel investments to date, primarily led by investors from Asia and the Middle East, representing an increase over the prior three-year average of 29.7%.⁶⁰ Over the past year, Asian investors have invested most heavily in international gateway cities with a heavy population of Asian nationals and in large mixed-use projects, leveraging their development experience and significant customer base in their home countries.

Offshore investments from Asia have experienced a recent high, with investors acquiring a total of US\$28 billion in commercial real estate outside of Asia year-to-date through November 2013, compared to US\$19.7 billion in 2012.⁶¹ Mainland China has been the most active buyer this year, acquiring 33.3% of the total invested capital outside of Asia, followed by Singapore (30.9%), Hong Kong (13.1%) and South Korea (11.9%).⁶² The Chinese have experienced more than 400% growth in overseas acquisitions in the past three years,⁶³ primarily due to state-owned enterprises seeking development opportunities, investors diversifying into stable markets and the nation liberalizing regulations for investing abroad. With the surge in capital deployed, comparisons have been drawn between the investment appetite of the Chinese today versus the

Japanese in the late 1980s and early 1990s. During the peak in 1989, Japan's foreign direct investments in real estate totaled US\$14.1 billion, of which US\$13 billion was directed toward real estate outside of Asia.⁶⁴ While China's investments outside of Asia topped US\$9.3 billion to-date,⁶⁵ overseas investment volumes are expected to further increase 20% annually over the next decade.⁶⁶

Gateway cities remain the most attractive cross-border investment markets for Asian investors. For example, year-to-date through November 2013, London, Manhattan and Sydney comprised 60.3% of the capital invested in non-Asia markets,⁶⁷ indicating a "herding" mentality for investors seeking outbound opportunities. With hotel acquisitions topping US\$1 million per key, Asian investors illustrate their preference for

60. Trends & Trades, November 2013, *Real Capital Analytics*, 19 November 2013.

61. Cross-Border Capital Tracker, November 2013, *Real Capital Analytics*, 19 November 2013.

62. Cross-Border Capital Tracker, November 2013, *Real Capital Analytics*, 19 November 2013.

63. Cross-Border Capital Tracker, November 2013, *Real Capital Analytics*, 19 November 2013.

64. Roger Simon Farrell, *A Yen for Real Estate: Japanese Real Estate Investment Abroad – From Boom to Bust*, 2000.

65. Cross-Border Capital Tracker, November 2013, *Real Capital Analytics*, 19 November 2013.

66. "China Overseas Property Investment up 600 Percent," *World Property Channel*, 9 September 2013, www.worldpropertychannel.com/asia-pacific-commercial-news/chinese-overseas-property-investment-savills-investors-developers-real-estate-investment-chinese-investors-sovereign-wealth-funds-7323.php, accessed 19 November 2013.

67. Cross-Border Capital Tracker, November 2013, *Real Capital Analytics*, 19 November 2013.



secure assets in transparent markets, such as the US, UK and Australia, over higher-yield opportunities. Viewed as safe markets, gateway cities will continue to be the priority for many investors going forward. For example, a prominent developer in China has ambitious plans to build 15 luxury hotels annually in up to 10 major international cities over the next decade, with London and Manhattan in the works.^{68,69} However, smaller recent acquisitions in strong secondary cities illustrate that savvy investors may be heading toward rising markets for geographic diversification, higher yields and larger lot sizes, especially as investors seek value-add opportunities. Cities such as Seattle and Houston, for example, have gained an increasing interest with Chinese investors given strong job growth in the technology and energy sectors, coupled with the rise in the local Chinese population.⁷⁰

Construction activity is also rebounding, as illustrated by the billions of dollars invested in transformational mixed-use projects by well-capitalized Asian investors. For example, over the past year, a Chinese state-owned Fortune 500 company announced multiple development projects, including a US\$1 billion mixed-use hotel project in downtown Los Angeles,⁷¹ a US\$497 million residential

and hotel tower in Sydney⁷² and up to US\$1 billion investment in a health care tourism town in Jeju, South Korea.⁷³ China is not the only Asian country optimistic about the hotel industry in downtown Los Angeles; a South Korean conglomerate is in the process of building a US\$1 billion mixed-use tower with 900 guestrooms, which will be the tallest tower west of the Mississippi River upon completion.⁷⁴ And after years of post-recession decline in the tourism industry, construction is returning to Las Vegas. Earlier this year, a Malaysia-based gaming company purchased an 87-acre site for US\$350 million, with plans to build a 3,500-guestroom resort with a 175,000-square-foot casino. With the resort designed as a replica of the Great Wall of China, the company plans to use its name recognition in Asia to attract foreign travelers to Las Vegas.⁷⁵

While national insurance companies could emerge as new investors given recent regulatory changes, thus far many of these companies have waited cautiously by the sidelines given strict investment hurdles. In October 2012, the China Insurance Regulatory Commission issued its rules for investing in overseas real estate. With total assets of US\$1.2 trillion in 2012, analysts predict Chinese insurance institutions have approximately US\$14.4 billion available

68. "China's Dalian Wanda to Build Hotels Overseas," *The Wall Street Journal*, <http://online.wsj.com/news/articles/SB10001424127887324021104578554322805576546>, accessed 19 November 2013.

69. "Wanda to Invest \$8.2 Billion in Park, World's Largest Studio," *Bloomberg*, 22 September 2013, www.bloomberg.com/news/2013-09-23/wanda-to-invest-in-park.html, accessed 21 November 2013.

70. "Chinese Property Investors Widen Footprint in U.S.," *The Wall Street Journal*, 24 September 2013, <http://online.wsj.com/news/articles/SB10001424052702303983904579094723756080610>, accessed 10 November 2013.

71. "China's Greenland Buys Stake in Los Angeles Project," *Bloomberg*, 26 July 2013, www.bloomberg.com/news/2013-07-26/china-s-greenland-enters-u-s-in-1-billion-los-angeles-project.html, accessed 10 November 2013.

72. "Greenland Group Plans \$957 Million Australian Investment Push," *The Wall Street Journal*, 29 October 2013, <http://online.wsj.com/news/articles/SB10001424052702304200804579164692886910688>, accessed 10 November 2013.

73. "China's Greenland Group Decides to Invest in Jeju," *The Korea Times*, 12 July 2012, www.koreatimes.com/story/22308/china%E2%80%99s-greenland-group-decides-invest-jeju, accessed 10 November 2013.

74. "South Korea Firm Aims for the Sky in L.A.," *Los Angeles Times*, 08 February 2013, <http://articles.latimes.com/2013/feb/08/business/la-fi-downtown-skyscraper-20130208>, accessed 10 November 2013.

75. "Malaysia's Genting to Buy Las Vegas Site for \$350 mln in US Push," *Reuters*, 4 March 2013, www.reuters.com/article/2013/03/05/genting-las-vegas-idUSL4N0BX0D820130305, accessed 10 November 2013.





Strength and saturation in the global gaming market

In recent years, gaming has seen a rapid expansion in the US and abroad given increased social acceptance and favorable government policy. Amid the early stages of a global economic recovery, many governments have been turning to gaming as a method of increasing tax revenue and tourism spending that historically has been captured by alternative destination points.

However, this trend raises the concern that certain regions may be at or nearing saturation. As such, new additions to supply in these markets result in cannibalization of existing demand, leading to lower than expected revenues. This trend is anticipated to disproportionately hurt weaker market participants and inferior properties. Furthermore, the development of high-end gaming resorts in various regions has had far-reaching implications for VIP

play in competing markets. As a further consequence of market saturation, publicly traded companies in the gaming industry, currently trading at or near all-time highs, may seek to rely on inorganic forms of growth such as mergers and acquisitions, stock structuring and online gaming to remain competitive.

In the US specifically, gaming executives have voiced concerns that many regional gaming markets are already saturated. In recent years, Maryland, New York, Ohio, Pennsylvania, Illinois and others have passed legislation permitting the legalization or expansion of existing gaming facilities, which will lead to further dilution of established gaming markets such as Las Vegas and Atlantic City, as well as Native American casinos. Further, numerous other states and local municipalities continue to evaluate the prospects of legalizing gaming in some form. The increase in gaming supply is causing a shift in revenue distribution and market share between states, particularly in the Northeast, Mid-Atlantic and Midwest regions. New Jersey highlights the potential

impact that new gaming supply can have on surrounding markets, as it was recently replaced by Pennsylvania as the second largest casino market in the country. Atlantic City's casino revenue has declined 44% since Pennsylvania opened its first casino in 2006.

According to the American Gaming Association, the total number of commercial, racetrack and tribal casinos in the US, excluding Nevada, increased approximately 20% from 2006 to 2012, with many of the recent additions coming in the form of larger Las Vegas-style resort casinos. Additionally, the total number of states with commercial land-based or riverboat casinos increased from 11 to 17 over the same period.⁷⁸ The trend of increased gaming supply is anticipated to continue in the near term as states and local municipalities seek to increase tax revenues. According to analysts, the supply of gaming positions on the Atlantic Coast (including Atlantic City, Connecticut, Delaware, Maryland, New York and Greater Philadelphia) is anticipated to increase by approximately 17% over the next

78. American Gaming Association website, www.americangaming.org/sites/default/files/uploads/docs/aga_sos2013_fnl.pdf and www.americangaming.org/sites/default/files/uploads/docs/sos/aga-sos-2006.pdf, accessed 26 November 2013.



three to four years, causing declines in same-store revenues and earnings before interest, taxes, depreciation and amortization (EBITDA), which is the metric most keenly focused upon for the gaming segment.

In response to increasing competition from regional casinos throughout the US and international gaming destinations such as Macau and Singapore, Las Vegas is positioning itself as a unique entertainment destination with a complement of non-gaming forms of entertainment, including restaurants, nightlife and shopping. The Nevada Gaming Control Board reported that gaming revenue accounted for approximately 36% of total revenue on the Las Vegas Strip in 2012, representing a significant decrease from historical periods. By comparison, gaming revenue accounted for 55% to 60% of total revenue on the Las Vegas Strip in the early 1990s.

The Asia-Pacific region is drawing significant attention in the global gaming industry as Macau continues to expand its dominance as the largest gaming market in the world. Macau is likely to surpass US\$43 billion in gaming revenue in 2013, which is more than all of the commercial casinos in the US combined. Macau is nearly six times the size of the Las Vegas market based on 2012 revenue, and it achieved a record US\$4.6 billion in revenue in the month of October 2013 alone.⁷⁹

Despite the continued strength of Macau and, more recently, Singapore, gaming analysts are expecting gaming revenue growth to slow in these markets in coming years as the market copes with

new supply and additional projects in the development pipeline, including the continued build-out of Macau's Cotai Strip, as well as the legalization or expansion of gaming in markets such as Japan, South Korea, Thailand and Vietnam. In March 2013, Solaire, the first of four planned gaming destination resorts, opened in Entertainment City near Manila in the Philippines. Macau's Cotai Strip alone currently has multiple multibillion-dollar casino development projects in various stages of construction. However, the additional competitive pressure is anticipated to disproportionately affect other gaming markets in the Asia-Pacific region such as the Philippines and Australia.

France, Germany and South Africa have the largest casino markets in the Europe, Middle East and Africa (EMEA) gaming region, while the gaming industries in countries such as Italy and the UK consist of a majority of gaming machines located outside of casinos. As Europe is generally considered a more mature gaming market, little supply growth is anticipated with limited new resort casinos in the pipeline for Spain, Ireland and Switzerland.⁸⁰

Although the gaming markets in Latin America are less developed, new supply additions are limited by caps on the number of licensed casinos allowed in each country. In Argentina, South America's largest gaming market, casinos are licensed by the provincial government, instead of the national government.⁸¹ Some analysts in the industry list Mexico and South America among the few remaining markets in the world with strong potential for future gaming industry development.⁸²

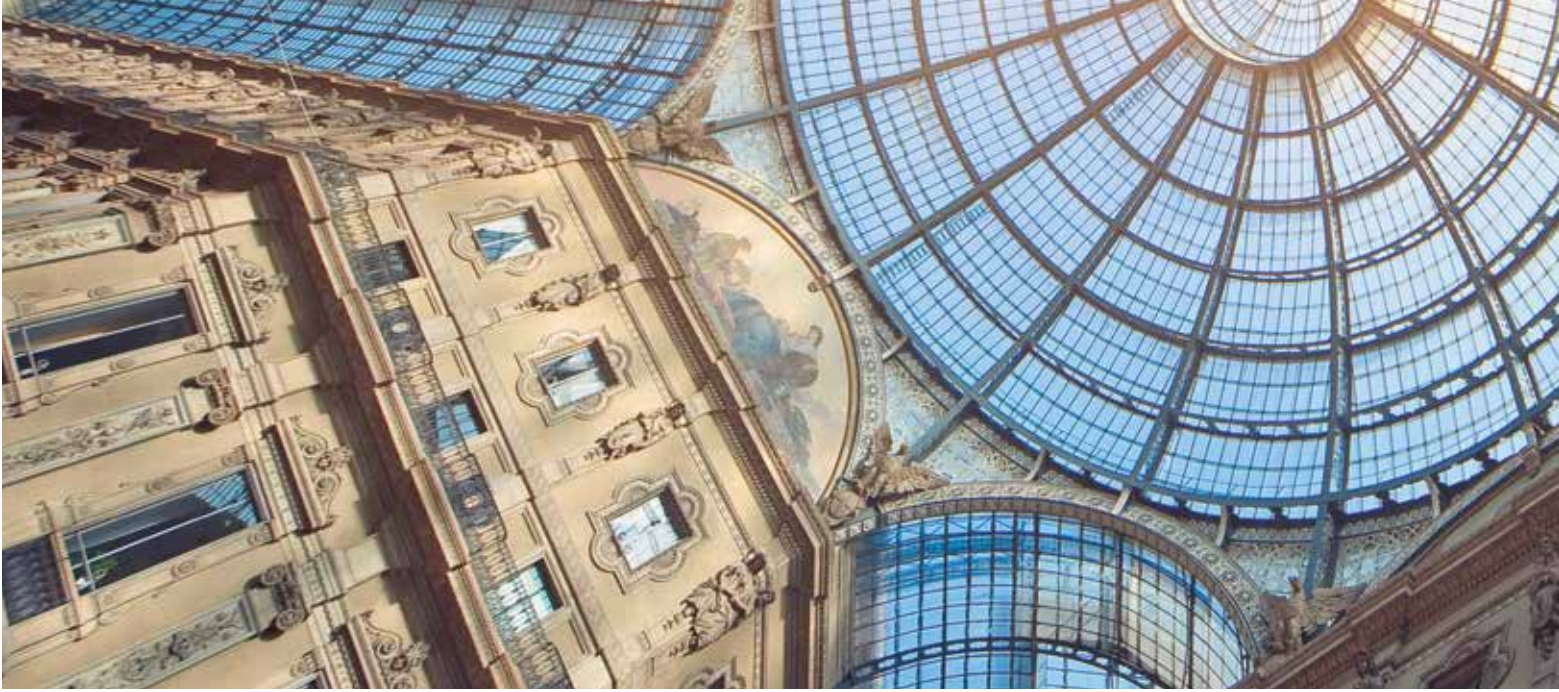
As a result of the prospect of slowing long-term growth in the global gaming industry, many gaming companies are jostling to position themselves to capitalize on the potential for larger-scale legalization of online gaming. Three states in the US and other countries have some form of legalized online gaming, the industry is still considered to be in its infancy, with the true revenue potential and impact on brick and mortar casinos relatively unknown at this time.

79. Steven Stradbroke, "Macau Casinos Shatter Old Revenue Record with \$4.57b Haul in October," *Calvinayre.com website*, <http://calvinayre.com/2013/11/01/casino/macau-casinos-shatter-revenue-record-in-october/>, accessed 26 November 2013.

80. *Global Gaming Outlook*, PwC, 2011.

81. *Global Gaming Outlook*, PwC, 2011.

82. Richard Velotta, "Gaming execs say casino industry has reached saturation point," *VegasInc website*, www.vegasinc.com/news/2013/sep/26/gaming-execs-say-casino-industry-has-reached-satur/, accessed 26 November 2013.



Hotel valuation on the upswing

Around the globe, hotel values are strengthening and lodging metrics are continuing to improve. Investors remain focused on strong, transparent hotel markets, while also seeking opportunistic investments in emerging lodging markets, such as Mexico. Heightened transparency across the world's real estate markets has provided investors with greater insight into market dynamics and performance, allowing real estate investors to broaden their global reach.

Greater market transparency has driven international competition and established global best practices. According to Jones Lang LaSalle's *Global Transparency Index*, the US remains the world's most transparent market, in addition to the UK, Australia and the Netherlands.⁸³ Market transparency directly influences hotel values; as more market data becomes readily available, more data points exist on which to base estimates of value, further supporting educated investment decisions.

Hotel values in the US have increased since the lows of 2009 and 2010, as hotels in many markets (particularly those in major metropolitan areas) attain pre-recession operating fundamentals. Due to the low interest rate environment, capitalization rates have remained relatively stable at historic lows over the past few years, while average prices per key have increased year over year, with growth anticipated to

continue through 2016. Naturally, some of the harder-hit markets throughout the recession (such as those in South Florida) are expected to see high per-room value increases due to improving visitation (both domestic and international) from increased leisure and corporate travel.⁸⁴ Overall, US hotel investors are confident about future income gains from a prolonged market recovery, but they remain conservative when forecasting future operating performance due to uncertainty surrounding the global economy.

In Latin America, Mexico has experienced suppressed asset values, resulting in ever-increasing investor interest as opportunistic buyers shift their focus from Brazil. Given Mexico's proximity to the US, the country's expected 4% annual GDP growth over the next few years, sophisticated financial markets and

83. *Global Transparency Index*, Jones Lang LaSalle, 2012.

84. *U.S. Hotel Valuation Index 2013*, HVS, July 2013.



large international-grade hotel supply, capitalization rates and yields continue to decrease as investor confidence increases. In 2012, three of the five lowest average lodging market capitalization rates in Latin America were in Mexican markets (Mexico City, Los Cabos and Cancun), further demonstrating Mexico's strong fundamentals.⁸⁵

Europe is currently experiencing a more favorable trading environment and greater debt availability than during the past few years, and investors remain optimistic that the financial crisis has passed. Despite the recent lull in the number of portfolio transactions, individual asset sales are active with valuations around 7 to 10 times EBITDA. With the 2012 Olympic Games over, London remains a strong hotel market; however, growth in value is constrained due to the influx of new supply and decreases in transient demand. Investors' appetite for Paris remains healthy, and RevPAR continues to grow primarily by increasing room rates. Paris' hotels are valued the highest in Europe, with an average value of US\$659,819 per room in 2012, well above its historical peak in 2007. Munich's hotel market continues to be a top performer, experiencing a high percentage growth in hotel values compared to other European markets in 2013, while Madrid, Lisbon and Athens experienced limited growth. Moscow, a key gateway lodging market, continues to capture investor interest, ranking in the top 10 hotel values in Europe. Moscow is achieving an average of

US\$344,355 per room, well above the European average of US\$240,307 over the past year. Although concerns surrounding the European financial crisis remain, investors continue to focus on key, transparent markets to reduce their level of risk.⁸⁶

In Asian markets, investors have been seeking investments in locations they consider to be more transparent, resulting in increasing demand in markets such as Hong Kong, Singapore and Tokyo. Strong competition in these locations has resulted in an increase in hotel development land prices. But in other less transparent Asian markets, such as Mainland China, some sellers have countered difficulty in selling their assets. With such a dichotomy in the overall Asian market, it is essential to choose a valuation methodology and key assumptions that are aligned with the characteristics of the local market.

India's travel and tourism have been improving over the past few years due to the country's robust economy, expanding middle class, growth in foreign tourism and synchronized capital government. The midscale lodging segment continues to exhibit the strongest performance. Hotel values in India have been under heated debate post-recession; investors have focused on EBITDA multiples and income generation, while owners focus on the underlying real estate value. This has resulted in a valuation gap between the two parties and, therefore, an extended deal completion time frame.

Global trading continues to recover, particularly when compared to 2012. Around the world, lodging metrics continue to improve and hotel values are strengthening, resulting in renewed global optimism. While global capitalization rates continue to contract or remain at all-time lows, it remains important for hotel investors to closely follow both current and future market trends that could affect hotel valuation. Investors also should enlist the assistance of industry and local market experts with deep knowledge of hotel valuation.

85. *Hotel Investor Sentiment Survey (Latin America)*, Jones Lang LaSalle, May 2012.

86. *European Hotel Valuation Index 2013*, HVS, February 2013.

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EYG no. DF017
CSG/GSC2013/1210766
ED 0714

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