

News release

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2011 to see reawakening of hospitality sector

Emerging markets set to propel global hospitality growth

New York, London and San Diego, 24 January 2011 -- According to a report released today by Ernst & Young, a series of financial, operational, demographic and regulatory trends suggest that global hospitality markets will see more robust, broad-based growth by the end of this year.

In its latest report, *Global Hospitality Insights: Top Thoughts for 2011* – released today in conjunction with the start of the annual Americas Lodging and Investment Summit (ALIS), held in San Diego – Ernst & Young’s global hospitality team identifies and discusses several key trends which they expect to have a major impact on the lodging industry in 2011.

“While the industry has suffered two years of declining fundamentals and endured the drag of a global economic recession, we believe that the worst is over and the light at the end of the tunnel is not only visible but growing larger each day,” said Michael Fishbin, Leader of Ernst & Young’s global hospitality practice. “Lodging sector recovery

is a fact; resurgence is no longer far away,” he added.

Limited supply may lead to demand squeeze

Hotel construction is down significantly worldwide since the recession and with business travel projected to pick up with the economy and capital constraints on new development, all signs point to declining occupancies and rising room rates, particularly in key global business markets such as New York and Hong Kong. In fact, Hong Kong has already seen a boost in one major hotel industry indicator: hotel revenue per available room (RevPAR), which saw 30% gains in November last year. Asian markets, in general, seem to be leading the global recovery in the hospitality sector.

The China factor

Not only is China expected to surpass US business travel by 2015, but the Asia region is expected to account for more than 41% of the worldwide growth in outbound travel and tourism over the next decade. Much of this increase could also come from China as a result of steps taken by governments in the Americas, Europe and Japan to expedite tourist visas for Chinese nationals.

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In addition to China, countries like Brazil, Russia and India will propel global hospitality market growth over the next few years. In addition to the booming growth of the middle class in these countries, growing national economies in countries like Brazil and India will spur both inbound business and leisure travel in the next decade. Brazil and Russia also have the added impetus of hosting not one, but two

global sporting events each in the next seven years: Brazil hosts the FIFA World Cup in 2014 and the Summer Olympics in 2016; Russia hosts the Winter Olympics in 2014 and the FIFA World Cup in 2018. As an example of the impact on local hotel markets, more than 300,000 people visited South Africa last summer to attend the 2010 FIFA World Cup with almost two-thirds of those visitors entering the country for the first time and spending the equivalent of more than US\$500 million during a four-week period.

New financing to be constrained

As governments around the world turn to regulatory reform to strengthen perceived weaknesses in financial oversight, access to new financing is likely to be constrained, potentially increasing hotel developers and operators cost of capital and further restricting the construction of new hotel properties. This is especially true in the US, where enactment of the Dodd-Frank Act includes sweeping changes for private equity funds and commercial mortgage backed securities, two sources which have historically been major capital contributors to the lodging sector.

Public markets offer outlet

While private capital sources may be constrained in the next few years, public markets may not be so difficult to tap. As the global economy recovers and grows and hotel market fundamentals improve, more hotel owners may be able to access public equity markets for fresh capital. One way to do this is to form a real estate investment trust (REIT). In the US market there are 11 listed hotel REITs with a total market cap of US\$23 billion. One of

the advantages of public market financing that is likely to attract private hotel owners, in addition to fresh capital, is the relative stability that a public listing provides. Unlike some of their private sector counterparts, most public hotel REITs came through the last recession avoiding bankruptcy.

As fundamentals improve, investors return.

One scenario Ernst & Young expects to see in 2011 is the return of opportunistic investors to the hotel sector. "We've seen a few distressed asset and note purchase opportunities in the last 12 months and we have no doubt there will be more in 2011, but we also expect to see equity investors take advantage of opportunities presented by upcoming debt maturities to purchase institutional grade assets this year," Fishbin said. Several recent surveys of the hotel investment sector have been bullish, with most observers anticipating occupancies, ADR and net operating income returning to peak levels in 2012, 2013 and 2014, respectively. With these fundamentals improving, investors are likely to want to lock in deals before the numbers get too good and prices rise, the report suggests.

The report also looks at some of the trends that may potentially alter hotel company operations in the year ahead. Among those identified are likely changes in accounting methods used throughout the hotel industry as a result of the ongoing convergence of US GAAP accounting and International Financial Reporting Standards (IFRS). The greatest areas of concern for hotel entities, operators, managers and franchisors will be in the areas of lease accounting and revenue recognition as new standards for both will substantially impact the balance sheets and income statements of most every company

operating in the sector.

Similarly, the report suggests, the global economic recession has forced hotel companies to reconsider their capital strategies in order to gain more flexibility in future downturns. Before the last recession, many companies had taken riskier financial positions such as short-term, low-cost borrowing to leverage their operations and this threatened many during the last downturn as refinancing sources dried up and terms toughened. Today, as a result of that experience, more companies are deleveraging where they can and are holding excess cashflow to fund discretionary spending rather than seeking to borrow. “Today, managing capital has become a key concern for hotel companies as they seek to plant the seeds of their competitiveness tomorrow,” said Fishbin.

To access a full copy of the report: *Global Hospitality Insights: Top Thoughts for 2011*, visit www.ey.com/realestate.

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