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Hotels in Australia 1988-2003 : a tale of booms and busts

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Hotels in Australia 1988 – 2003

A Tale of Booms and Busts

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Abstract

This paper reviews the development of Australia's hotel sector over a 15 year period and uses this analysis as the basis for suggesting the likely shape of future developments. The underlying dynamics of hotel development and subsequent performance are shown to reflect a continuing pattern of boom and bust. The late 1980s were characterised by a building boom in the lead up to the Bicentennial and World Expo celebrations. This was soon followed by a bust during the recession of the early 1990s. In the lead up to the 2000 Olympics another building boom occurred, particularly in Sydney leading to the predictable oversupply of rooms and subsequent stalling of construction during 2003. A change has been evident amongst developers from their view of hotels as a component of commercial property development towards a stronger connection between inner-city residential apartment developments and hotels.

Keywords: accommodation, Australia, hotel development.

Introduction

In recent years the Australian hotel industry has experienced considerable market turbulence. As noted in the report *Hotels in Australia*, a number of major new hotels entered the market in the lead up to the Sydney 2000 Olympics (McVey and King 1998). Though the staging of the Games in Sydney was widely reported as having achieved great success, the anticipated surge in international visitation to the country did not eventuate. Whilst New Zealand achieved growth of 7 percent during 2001, international arrivals to Australia over the same period fell by 2 percent. International arrivals stalled in the aftermath of the September 11, 2001 terrorist attacks and the subsequent 'War on Terrorism' and associated leading to military campaigns.

The Australian hotel industry was also badly affected by the collapse of Australia's second largest carrier in September 2001, Ansett Airlines. Domestic and international airline services were cancelled or significantly curtailed. The launch of the low cost domestic carrier Virgin Blue and its announcement of plans to expand internationally to New Zealand and Fiji has subsequently alleviated the reduction in air services. However at the time of its launch it was unable to fill the gap left by Ansett and compensate fully for the already difficult operating environment. Subsequently the operating environment has to some extent stabilised. The prospective launch of new domestic low cost carriers (LCCs) including the Qantas-owned Jetstar may help to improve market conditions with associated benefits for the accommodation sector.

Tourism Demand

In this paper we provide a comprehensive diagnosis of Australia's hotel sector over a 15 year period, drawing upon a wide range of secondary supply and demand data. It is intended that by incorporating strong series data, the paper

will provide a sense of longer term trends and insights into likely future events from a supply, demand, investment and development perspective.

The health of hotels and the commercial accommodation sector derives substantially from tourism demand trends. Fewer international tourists arrived in Australia during 2001 and 2002 prompted by fears of an economic downturn in the United States, continued deflation in Japan and the lingering effects of the Asian Financial Crisis in key markets. On a more positive note, the Bureau of Tourism Research (BTR) reported that domestic tourist trips increased during 2002, albeit by a modest 1 per cent. Whilst particularly welcome for destinations outside the urban areas, this growth has been insufficient to offset the ongoing over-supply of hotel rooms.

Table 1 shows the scale of international and domestic tourism in Australia during 2002. Domestic tourism generates nearly three times as many visitor nights as international tourism. The discrepancy is however even more pronounced in the case of hotel, motel and guesthouse room nights. The demand from domestic tourists for these categories of accommodation is six times its equivalent amongst international tourists.

Insert Table 1 about here

Accommodation Stock

The value of completed accommodation projects reached its highest level for more than a decade in 2000, posting an increase of 21 per cent in room supply (worth AU\$1,320 million) over the previous year. Half of this new investment occurred in New South Wales, Australia's most populous state. Over the period 1998 to 2000, in excess of AU\$1,242 million of new tourist accommodation was added in New South Wales alone, mostly in Sydney.

Insert Figure 1 about here

In 2000, the number of applications and approvals for new tourist accommodation declined dramatically with a drop in approvals by 42 per cent over 1999. Into 2001 the value of completed accommodation developments slumped by more than 80 per cent over 2000, continuing the earlier trend. In the run-up to the Olympics much of the growth in tourist accommodation consisted of 4 and 5 star establishments in New South Wales (Australian Bureau of Statistics 2001). Whilst the supply of tourist accommodation in New South Wales was 25 per cent, Australia-wide capacity grew by a more modest 13 per cent between 1997 and 2000. This suggests that supply does experience a peak in the lead up to the hosting of major events and that such growth, while reflected nationally, is concentrated in the area hosting the event.

Insert Table 2 about here

The number of both establishments and rooms in Australia contracted slightly during 2001 and 2002. As shown in Table 2, this was the case for hotels, motels and guesthouses. With the largest hotel room supply, New South

Wales witnessed the largest contraction (almost five per cent). Between 2001 and 2002 14 Sydney hotels went out of business, many of these in the King's Cross Area which has been a well established tourist precinct. These closures included a number of well-known properties such as the Landmark, the Gazebo, the Sebel, the Chateau, the Manhattan and The Top of the Town. Some were converted into apartments by their owners, encouraged by escalating real estate values and the disincentive to refurbish when average room rates are trending downwards. The closures and conversions mark a new trend in Australia's accommodation supply. It suggests that crossovers may occur in cases where supply within a particular accommodation segment grows to unsustainable levels. The serviced and residential apartment sector may be the main beneficiaries, though with plateauing prices and emerging oversupply in Melbourne and Sydney, it is not inconceivable that future conversions could follow a reverse pattern.

In 2002 New South Wales also exhibited the largest contraction of room supply in the motels and guesthouses sector, followed closely by Queensland. Tasmania, the smallest and least populous state, reported a surprising 9 per cent increase following the addition of 6 new establishments. Nationwide the supply of motel and guesthouse establishments and rooms declined by around 1 per cent in 2002.

Insert Table 3 about here

Given the drop in room capacity over the same period, it is perhaps not surprising that total revenues contracted over the period 2001 – 2002. As is indicated in Table 3, this occurred despite the fact that there were slightly more room nights sold. Lower revenues and higher sales resulted in a slight increase in the average annual occupancy rate country-wide. In the case of room rates the scale of decline closely matched the rise in average annual occupancies.

Insert Table 4 about here

Australia is quite well served by reports which provide an annual overview of the accommodation sector. An annual Hotel Industry Survey is published by Horwath Asia Pacific (2002). Table 4 presents data from the most recent survey and shows that on average, nearly 2 out of every 3 guests originated from within Australia. 'Luxury' hotels had a significantly higher proportion of international guests.

Asia is the biggest source of international guests for all hotels in Australia (13.4 per cent) followed by Europe (8.7 per cent). New Zealand ranks third with 7.2 per cent. This pattern varies across the three categories of hotel accommodation. In the case of 'Economy' hotels, Asia is still the main market for international guests with Europe (8.5 per cent) and New Zealand (7.0 per cent) ranking second and third respectively. In the 'First Class' hotel category, New Zealand (10.1 per cent) edges Asia (10.0 per cent) into second place with Europe (6.5 per cent) ranking third. However, in the 'Luxury' hotels surveyed, North America (16.7 per cent) generates the largest proportion of international guests followed by Europe (13.5 per cent), with Asia (11.1 per cent) in third place. The fact that the markets for 'Economy' hotels closely match the markets for all hotels suggests that 'Economy' hotels predominate within the survey. The figures for different types of property indicate that Australia is quite fortunate in having a wide spread of source markets. The fact that the strength of Asia, Europe and North America varies markedly across different accommodation types, does mean that problems in particular source markets (eg SARS in Asia and 9/11 in North America) have differing impacts on different accommodation types. At the time of writing (early 2004) the substantial appreciation of the Australian dollar relative to the US dollar is likely to have a significant impact on the luxury hotel sector which is disproportionately reliant on North American sources.

Across the range of properties that were surveyed, around two thirds of guests were either Tourist/Leisure FIT (32.7 per cent) or Business Travellers (31.8 per cent). Tour groups (14.2 per cent) provided the third largest component of the market mix. These are also the three dominant market mix in the 'Economy' and 'First Class' hotels that were included in the survey. However, 'Economy' hotels received more Tourist/Leisure FIT guests (35.9 per cent) than Business Travellers (25.7 per cent). In the case of 'First Class' hotels, Business Travellers (37.3 per cent) comprise the largest segment followed by Tourist/Leisure FIT (26.1 per cent). In 'Luxury' hotels business Travellers (43.1 per cent) comprise the biggest segment followed by Tourist/Leisure FIT (33.3 per cent). Meeting Participants (8.0 per cent) providing a larger proportion of guests than Tour Groups (14.2 per cent) in 'Luxury' hotels. During 2002, 2 nights was the typical length of stay for both international and domestic guests. In contrast, domestic guests in 'Luxury' hotels tended to stay longer (2.7 night) than those staying in 'Economy' or 'First Class' hotels (both 2.0 nights). International guests stayed slightly longer in 'Luxury' hotels (2.1 nights) than in 'Economy' and 'First Class' hotels (both 1.8 nights).

The Horwath Asia Pacific survey indicated that the leading method of advance reservation is by direct inquiry. In the case of both 'Luxury' and 'First Class' hotels, travel agents are the second leading source of advance reservations, followed by hotel owned global distribution systems. For 'Economy' hotels, the second largest source of advance bookings was their in-house reservation system with tour operators ranking third. Despite the widely held view that the internet is a significant source for advance reservations, the survey found that less than 4 per cent of actual bookings are made through either the hotel's website or other internet sites. This applies to both the 'Economy' and 'First Class' hotels included in Horwath Asia Pacific's survey. 'Luxury' hotels generated slightly more advance reservations from either their own website or other internet sites (6.5 per cent). A note of caution is appropriate since many guests use a variety of methods to research their choice of hotel prior to making an advance reservation. The internet is undoubtedly an important

source of information for many respondents who report making internet enquiries prior to making reservations. Most people still however appear to prefer an element of personal contact when making advance reservations.

Insert Table 5 about here

Table 5 provides a breakdown of departmental revenues and expenses for the hotels included in Horwath Asia Pacific survey. The average occupancy rate for all hotels (69 per cent), is higher than the figure recorded by the Australian Bureau of Statistics (62.6 per cent). The average size of property in the Horwath Asia Pacific report was 223 rooms, perhaps indicative of skewing towards larger city centre properties. During financial year 2001-2002 average room rates in the ABS survey were AU\$137.50, slightly down on the previous year (AU\$139.50). The average room rate for hotels included in the Horwath Asia Pacific survey was somewhat lower AU\$130.

'Luxury' hotels achieved the highest average room rate (AU\$230), but the lowest average occupancy rate (66 per cent). From an operator and investor point of view, the comparison with equivalent properties overseas is not encouraging. In mid 2002 the corporate rate for Sydney's Four Seasons Hotel was AU\$225. Based on prevailing exchange rates, its equally ranked property in London charged a rate equivalent to more than three times this level. 'First Class' hotels in Australia achieved an average room rate of AU\$143 and the highest occupancy rate of 70 per cent. 'Economy' hotels achieved an average room rate of only AU\$95, well below the overall average. Nevertheless, their average occupancy rate of 69 per cent matched the figure reported by all hotels.

As might be expected, room departments generated the most significant proportion of revenues, accounting for 61 per cent overall. This was followed by food and beverage departments with 33.5 per cent of total revenues.

'Economy' hotels achieved a higher proportion of revenues from rooms (65.1 per cent) and a lower proportion from food and beverage (30.4 per cent). The opposite was the case for 'First Class' hotels, with room revenues accounting for a lower proportion of total revenues (57.3 per cent) and food and beverage revenues accounting for a higher proportion (37.6 per cent). 'Luxury' hotels came closer to the overall average with 60.4 per cent of revenues derived from room sales and 32 per cent of revenues from the sale of food and beverage.

Across the three categories of hotel considered in the survey, departmental expenses were more evenly matched. Operating costs within room departments averaged 34.3 per cent of room revenues compared with food and beverage department costs averaging 83.7 per cent of departmental revenues. The minor revenue generating sources (telecommunications and others) also had high expenses averaging 71.8 per cent and 69 per cent respectively. Gross operating incomes were remarkably similar across the three categories of hotel and average gross operating incomes were within one percentage point of the overall 48.2 per cent average for all categories. The same observation may be applied to undistributed operating expenses which averaged 18.9 per cent of overall revenues. Some significant variances were evident within the category of marketing expenses. 'Luxury' hotels allocated an average 5.9 per cent of revenues to marketing activity, compared with the overall average of 4.6 per cent. By way of comparison 'First Class' and 'Economy' hotels both averaged an allocation of 4.2 per cent. This reflects the stronger emphasis given by upscale properties to creating and maintaining a luxury brand image and the higher cost of promotional materials associated with such market positioning.

Management fees (base and incentive) were remarkably similar across the three categories, accounting for an overall average of 2 per cent of revenues. They were only slightly higher (2.3 per cent) for 'Luxury' hotels compared to 'First Class' (1.9 per cent) and 'Economy' (1.8 per cent) hotels. A similar situation applied to payroll and related expenses which averaged 36.8 per cent of overall revenues. 'Luxury' hotels averaged 37.6 per cent with 'First

Class' and 'Economy' properties averaging 36.7 per cent and 36.4 per cent respectively.

It appears as if 'Luxury' hotels have been undertaking increasing marketing activity in order to boost stagnant occupancy rates . At the same time they appear to be by cutting costs on payroll and related expenses to improve operating profits. In a previous *Hotels in Australia* report which relied upon 1994 data, the overall average occupancy rate recorded by the Horwath Asia Pacific survey was 72 per cent (McVey and King 1995). During 2002 this dropped to an average of 69 per cent. 'Luxury' hotels recorded an average occupancy of 66 per cent in both years, well behind the average of 73 per cent for 'First Class' and 'Economy' hotels.

Significant shifts in expenditures were evident across the three categories of hotel. In 1994, 'Luxury hotels were allocating an average of 8.9 per cent of revenues towards marketing compared to the overall average 5.5 per cent. In 1994, payroll and related expenses accounted for 45.3 per cent of 'Luxury' hotel revenues compared to an overall average 36.6 per cent. As a result, income before fixed costs and management fees for 'Luxury' hotels was only 9.5 per cent of revenues in 1994 compared to an overall average of 23.9 per cent for all hotels surveyed. In 2002, 'Luxury' hotels achieved an average income before management fees and fixed charges of 29.2 per cent compared to an overall average of 29.3 per cent for all hotels surveyed. Over the past eight years, it appears that 'Luxury' hotels have benefited from their improving operational efficiency.

The downward pressure on rates prompted by the challenging external environment has led the Managing Director of Accor Asia-Pacific to point out that so-called "reverse auctions" are one of the most damaging recent trends. This practice involves on-line competition between hotels to secure corporate contracts. Increasing numbers of hotels have also been selling "distressed" rooms through websites such as www.lastminute.com.au which offer last minute five star rooms for as little as AU\$120 a night.

Insert Table 6 about here

In Table 6 performance indicators are provided for key cities and tourist destinations. All are located along Australia's eastern seaboard which is where most of the national population is concentrated. Brisbane achieved the highest occupancy rate with Sydney in second position, increasing its occupancies by 6 percent over 2002. Sydney hotels achieved the highest annual average daily rate (ADR) followed by Australia's second largest city Melbourne. Sydney also achieved the highest revenue per available room, again followed by Melbourne. During 2002 declines were reported for Melbourne in all three indicators. All of the other key destinations performed better during 2002, the only exception being a slight decline in Sydney's annual average daily rate.

The reduced supply of hotel rooms has benefited occupancy rates in Sydney. During the last quarter of 2002, revenues per available room increased by nearly 20 per cent over the third quarter. Continued increases in room supply for Melbourne have negatively impacted on all key performance indicators. The three Queensland destinations of Brisbane and the Gold Coast (in the south) and Cairns (in the North) each showed improvements in key performance indicators. In Brisbane reductions in room supply during 2002 boosted occupancy rates by more than 3 per cent with increases in both average daily rates and revenues per available room. Despite evidence of increasing demand, the growth of room supply on the Gold Coast ceased during 2002 leading to an improvement in all three key performance indicators. Despite fluctuating demand in Cairns, annual average daily rates remained fairly stable during 2002. Australia's tourism resorts have performed badly over the past two decades. Despite the continuous growth of domestic and international tourism over the period, profits and investment have actually

fallen. Australian resorts have suffered from low occupancies and poor yield relative to capital hotels in most states.

These are among the findings of a recent report commissioned by TTF Australia (formerly known as the Tourism Taskforce) and produced by Ernst & Young (Ernst and Young 2003). The report was published in 2003 and made recommendations for changing the way in which tourism is marketed generally and resorts are marketed in particular. The Ernst & Young conclusions make unpleasant reading for investors. High labour costs and fixed expenses, poor accessibility and growth in the supply of serviced apartments have all damaged the resort sector. According to UBS Warburg and the Australian Stock Exchange (ASX), the Standard & Poor (S&P)/ASX 300 Property index returned 11.1 per cent in the three years to July 31, 2002. During the same period, leading listed trusts that included resorts all failed to come close to this figure. The Grand Hotel Group recorded a negative 21.49 per cent return, Peppers Hotel Trust (now the Australian Hotel Fund) negative 18.78 per cent, Port Douglas Reef Resorts negative 3.09 per cent and Cypress Lakes Trust negative 2.21 per cent. Only Hamilton Island Trust based in Queensland's Whitsunday Islands posted a positive return. The result amounted to a return of just 2.84 per cent.

Ernst & Young's report states that 'despite the maturity of the resort market, there is still a lack of understanding of market and demand fundamentals by various resort development stakeholders, including developers, financiers and planners' (2003). The report points out that the big Australian resort developments of the 1980s, including Ayers Rock, Hyatt Sanctuary Cove and Sheraton Mirage Port Douglas and Gold Coast, were 'founded on unrealistic expectations of the strength of resort demand and poor understanding of resort investment principles'. The authors of the Ernst & Young report believe that the resort market is constrained by a perception amongst international visitors that airfares to resorts are too expensive relative to city packages. Resorts also rely largely on leisure tourists. City-based hotels appeal to less price sensitive corporate travellers.

Ernst & Young offer a number of proposals to improve resort performance. 'Older, luxury resorts need to revamp their conservative image (making them appear) active, fun and exciting if seeking to appeal to the family market. There is a growing need for retreat-style resorts, given the significance of existing demand'. To improve viability, resorts should focus on providing services and value for money to 'increasingly sophisticated domestic and international consumers'. The report concludes that resorts must capitalise on the perception of Australia as a safe place to travel to, and within during this period of uncertainty.

Hotel Ownership

Insert Table 7 about here

In a national survey carried out amongst 132 major owners, 393 establishments and 66,500 rooms, Jones Lang LaSalle identified the top ten owners of tourist accommodation in Australia (2003). The results shown in Table 6, demonstrate only one change of position since the previous annual survey. United Overseas Land dropped off the list as a result of the sale of its Landmark Parkroyal property in late 2001. United Overseas Land's place has been taken by Travelodge which opened a 275 room property in Southbank, Melbourne. It should be pointed out that Travelodge is separate from the prominent mid-scale brand previously operated by the former Southern Pacific Hotels Corporation (SPHC).

Singapore's Thakral Holdings maintained its position as the third largest owner in Australia on the Jones Lang LaSalle list, despite the sale of two of its properties during 2002. The conversion of the Sydney Stamford Plaza into residential apartments has made no change to Stamford Land Corporation's position. In contrast, General Property Trust (GPT) increased its portfolio

through the acquisition of three properties in Cape Tribulation, Queensland, and the refurbishment and addition to Ayers Rock Resort in the Northern Territory. GPT remains the sixth largest owner of tourist accommodation in Australia.

Insert Figure 2 about here

Hotel Investment

The virtual demise of Japan as a significant source of hotel investment over the last fifteen years has had a significant impact on the sector in Australia. This is a marked change over the late 1980s where there was a widely held popular misconception that Japanese investment would come to dominate the hotel industry throughout Australia. At one stage Japanese sources did account for a disproportional share of investment in a limited range of up-scale properties in specific locations (mainly in Far North Queensland and on the Gold Coast). As compensation for the drop in Japanese involvement, domestic investment has become increasingly evident. Singapore currently occupies second place as a source of investment, albeit well behind Australia.

Recently the Property Council of Australia and TTF Australia jointly commissioned a report exploring investor attitudes to hotel investment in Australia. *New Investment Frontiers – An Industry Action Plan for Reshaping Hotel Investment* (Jones Lang LaSalle 2003).

The report identified a number of impediments to investment. These include:

- trading volatility;
- poor past performance due to oversupply;
- returns to investors are not commensurate with risk;
- hotels tend to be over-valued;
- the hotel market is relatively illiquid and small scale;
- low barriers to entry contribute to over-supply; and
- unrealistic expectations on behalf of investors.

The report concluded that investors lack any clear understanding of the risks involved in hotel industry investment and that whilst the availability of reliable information has improved over the past decade, investors do not know how to use it. The authors argued that investors need to develop a better understanding of the risks involved and a more realistic expectation of likely returns.

A summary of the Jones Lang LaSalle recommendations is provided below:

- Taxation
 - Reduce travel taxes (eg. the tax imposed following the collapse of Ansett) or inject funds back into the industry;
 - Reduce or remove onerous levels of stamp duty on property transactions;
 - Eliminate the GST currently payable on stamp duty;
 - Educate the market about the 'going concern' rule;
 - Base depreciation on the effective life of an asset, rather than on its physical life;
 - Increase transparency and consistency across these state based taxes; and
 - Continue the current tax treatment of LPTs as trusts rather than as companies.

- Regulations
 - Remove the market distortions involving incentives for strata titled development to ensure a level playing field;
 - Regulate strata development offerings and introduce an accreditation of promoters;
 - Councils should require feasibility plans before granting development consent for accommodation; and
 - Eliminate compulsory inclusion of hotels in mixed use developments.

- Information/Education
 - Lessen the use of jargon;
 - Share business mix information between hotels;
 - Provide demand forecasts on a regional and business mix basis;
 - Publish development registers;
 - Improve the timing and reliability of the International Visitor Survey and the National Visitor Survey;
 - Compare hotel cycles with other property cycles to create arguments for hotel investment as a method of diversification;
 - Analyse sales and yields by buyer type, rather than in aggregate;
 - Create an accurate and tailored operational benchmark system for hotel owners; and
 - Educate investors as to the need to consider an exit strategy in the investment decision process.

- Profile of Hotel Investment Market
 - Ensure that the interests of hotel owners are adequately represented in the industry, perhaps by creating a sub-committee in an existing association;

- Increase the profile of hotel experts with institutional investors;
 - Push for the inclusion of hotels' in general and non-property investment discussions and seminars;
 - Target a high profile opinion leader institutional investor to invest in hotels; and
 - Raise the profile of hotels with asset consultants and understand their roles and requirements.
- Owner/Operator Alignment
 - Alignment could be improved by owners taking equity in management companies or operators taking an equity position in hotel investment;
 - Include performance incentives in management agreements;
 - Educate investors as to the role and availability of asset managers; and
 - Calculate incentive fees based on investment returns rather than Gross Operating Profit.
- Capital Intensive Nature
 - Undertake a triple net lease, with the operator taking responsibility for capital requirements;
 - Purchase a portfolio of well-balanced assets with different timing for capital expenditure to increase the pool of available funds;
 - Shorten the investment timeframe; and
 - Improve capital expenditure planning and operators' discipline with the use of the Furniture, Fittings & Equipment Reserve
- Investment Vehicles/Structures

- Ensure that any future hotel specific Listed Property Trust (LPT) takes into account the experience of past LPTs;
- Introduce income smoothing mechanisms into management agreements or replace with leases;
- Educate operators as to the benefits of leasehold agreements;
- Create tranching investments which offer differing levels of risk to satisfy different investment strategies;
- Package hotels with other property types to provide a spread of risk;
- Market hotels as an “alternative” rather than as a “core property” class;
- Research and understand the timing of the cycles before buying and selling;
- Package hotels as part of a mixed use development, to offer a diversified income stream;
- Improve the accuracy of forecasting and make pricing decisions according to the required yield premium for hotels given their risk;
- Package hotels into geographically diverse portfolios; and
- Create a hotel syndicate marketed at high net worth individuals, targeting growth.

With operational conditions softening across many Australian hotel markets during 2003, the prevalence of low interest rates provided the more highly leveraged hotel owners with some breathing space. Recent increases may change this. The prevailing business environment parallels conditions prevailing during the late 1980s when many hotel owners were confronted with the dual impact of higher borrowing costs and softening operational markets. The past year has seen a small number of lender foreclosures, involving highly leveraged hotels that have failed to react to rapidly changing operational markets. Given expectations of continued softness in some of Australia’s key hotel markets over the coming years, further foreclosures, loan

work outs or at least the provision of additional security to meet loan to value ratios (LVR) are likely.

Despite overall uncertainty and a softening of trading conditions in several key property types, a number of Australia's lending institutions are currently in the market for new hotel financing deals. Some of the larger lenders are however adopting a more cautious stance, opting to maintain their current portfolio in preference to increasing their hotel sector exposure. Any lending institutions in the market for new hotel financing deals expect to obtain a premium of at least 30-50 basis points over and above the rates required for fully let commercial property. In terms of LVR requirements, most banks set a limit of 50 to 60 per cent for senior debt, with both requirements reflecting the volatility of hotel assets.

Insert Table 8 about here

Hotel Management Groups

The Jones Lang LaSalle survey of 82 major operators across Australia included 552 tourist accommodation establishments comprising 83,500 rooms. The results are shown in Table 8. Several changes have become evident since the last survey. As was the case in 2001, Accor Asia Pacific Corporation (AAPC) remains the dominant force in hotel operations across Australia, followed by Six Continents Hotels and Resorts. Starwood Hotels and Resorts has expanded, with the opening of the Sheraton Four Points at Port Macquarie in Northern New South Wales. The company operates the Sheraton and Westin brands, as well as the boutique Hotel W brand. Pacific International Hotels has recently opened five properties. Its rise from eighth to fifth position between 2001 and 2002 is notable since the group has a strong emphasis on serviced apartments, rather than on hotel properties.

The appearance of serviced apartment dominated groups on the list of major management companies is likely to be a growing trend in view of the increasing preference by travellers for this type of accommodation. The Mirvac Hotels group has experienced an expansion for serviced apartments having secured the management of three properties during 2002. Mirvac is a major developer of residential apartments in inner urban areas such as Melbourne's Docklands. The entrance of Mirvac Hotels into the top ten has pushed Marriott International out of the list. Rydges Hotels & Resorts relinquished management of the Wentworth in Sydney to AAPC leading to the re-launch of this property under the Sofitel brand. The portfolio of Stamford Hotels and Resorts' declined when the Stamford Plaza Sydney was converted into residential apartments.

As well as a diverse range of properties under management, Accor has a diversified brand portfolio. These range from the five star Sofitel and Grand Mercure brands to the more functional and recently established Formule 1. Accor has also announced the establishment of a backpacker brand to be known as Base Backpackers. This initiative is indicative of Accor's intention to be a prominent operator across all market segments. The group has pursued its strategy of aggressive expansion through the acquisition of smaller chains including All Seasons, individual city properties such as the Victoria Hotel in Melbourne and regional properties such as Mount Buller Chalet in the Victorian Alps. When operating under its previous name of Bass Hotels and Resorts, the second largest hotel management group Six Continents, took over the SPHC management operations and proceeded to re-brand the Park Royal, Centra and Travelodge brands into Holiday Inns and Crown Plaza properties. A significant expansion of the latter brand has recently been announced with the re-designation of existing properties as Crown Plazas.

An omission from the list of property managers is Flag Choice. Previously known in Australia as Flag International this referral group is now under the umbrella of the US-based Choice Hotels and has more rooms under management than Accor. The group has a diverse range of brands covering different market segments and property types A significant proportion of the

properties are motel-style which explains its omission from Table 8. In most cases they compete with independent owner operated properties and with other referral chains such as Best Western rather than with the more up-scale managed groups such as Starwood and InterContinental.

Insert Table 9 about here

Table 9 provides the anticipated additions to the existing supply of tourist accommodation in major destinations as of mid-2003. In Sydney, there are currently no room expansions or new hotels under construction. However, at least 630 new rooms are proposed which, if completed, would increase the room supply by more than 3 per cent. More than 880 rooms are under construction in Melbourne, most expected to come on-stream during 2003/2004. These additions will increase the existing room supply by more than 6 per cent. Some 200 more rooms are proposed which, if completed, would expand the room supply by an additional 1.3 per cent. No new tourist accommodation rooms are currently under construction in either Brisbane or the adjacent Gold Coast. However, there are proposals to expand Brisbane's room capacity by 2 per cent whilst the Gold Coast could see its tourist accommodation expand by nearly 6 per cent. Cairns has more than 140 rooms under construction which will increase its capacity for tourist accommodation by a little over 2 per cent. Proposed additions could see room supply increase further by nearly 4 per cent. In total, these five major destinations expect their tourist accommodation room supply to increase by less than 2 per cent by 2004. Longer term they could see their combined room capacity increase by an additional 3 per cent. It is clear that the sector is emerging for a period of stagnation in terms of supply across most of the country into a period of modest recovery.

Hotel Property TransactionsError!

Insert Figure 3 about here

As is shown in Figure 3, the number of hotel transactions in Australia has been steadily declining over the past 15 years. More than 80 hotels were sold during 1998 valued at over AU\$5 million. By 2002, such transactions had fallen to less than 20 properties. The value of these transactions has been inconsistent. The value of hotels sold peaked in 1989 at around AU\$1.8 billion before collapsing to around AU\$300 million in 1991. The value of hotels sold during 2002 exceeded AU\$800 million, up on the value of those sold during 2001.

According to Colliers International Australia (CIA), there were four major hotel sales (defined as those with a price in excess of AU\$5 million) in Australia during December 2002. This raised the total number of major transactions for the year to 16, with a total value of around AU\$812 million. In comparison there were 19 major sales in 2001 with a total value of some AU\$705 million as shown in Figure 3. Australian purchasers accounted for 11 of these transactions, totalling some AU\$300 million or 37 per cent by value. The two largest deals of the year were GIC Singapore's purchase of the Westin and ANA hotels in Sydney accounted for a combined AU\$366.5 million or 45 per cent of total transactions for the year by value. The remaining 3 purchases featured investments from Malaysia, Macau and Thailand and accounted for 18 per cent by value.

In terms of value, Australian sellers accounted for 38 per cent of major sales in 2002, followed by Singaporean sellers (32 per cent) and Japanese sellers (29 per cent). Australian hotels sold during 2002 were located in either New South Wales, Queensland or Victoria. Despite the current global uncertainty with international tourism weakening in the first half of 2003 due to the impact of the conflict in Iraq and Severe Acute Respiratory Syndrome (SARS),

Colliers International Hotels expect investor interest in Australian hotels to remain firm.

The ABS recorded an improvement in the performance of tourist accommodation for the December quarter 2002, underpinned by an increase in international visitor arrivals and a reduction in room supply. International markets did not recover until a full year after the attacks of September 11, 2001. Given the severity of the prolonged drought and widespread bushfires in Australia the recovery arrived surprisingly quickly. Nevertheless, major US corporate collapses, renewed international terrorist threats and weak global economies remained as deterrents to international travel. The Australian dollar is also at its highest level for several years compared with the US dollar, the Japanese yen and the currencies of some of Australia's most important tourist markets. This will reduce Australia's price competitiveness as a tourist destination.

The negative impact of international events could be compensated by domestic tourism growth as Australian travellers defer overseas trips and opt to travel domestically. The incidence of the SARS virus also sparked further interest in travel to domestic destinations. In the aftermath of the conflict in Iraq, the domestic self-drive tour market has been a beneficiary of lower fuel prices. Other positive factors which led to an improvement in demand for tourist accommodation included the hosting of the Rugby World Cup in late 2003. The hosting of the Commonwealth Games in Melbourne in 2006 is also likely to provide an impetus for growth in Victoria.

Outside the major metropolitan areas, growth has focussed on destinations within easy reach of gateway airports that offer food and wine themes consistent with inner urban tastes. The Hunter Valley in NSW, Margaret River in Western Australia, the Barossa Valley in South Australia and the Yarra Valley in Victoria have all enjoyed better than average growth in visitation and have attracted increasing investment in boutique style accommodation.

Colliers International Hotels assert that RevPAR rose during 2002, having slumped in the previous year. They expect a slight delay in growth as a result of the conflict in Iraq and SARS and that optimism remains strong in Sydney supported by recent room supply reductions and the expectation of solid demand growth over the medium to long term. They also believe that increases in room supply in Melbourne will continue to have a short term negative impact on hotel performance. The 80 room Marque Rendezvous Hotel opened in early 2003, epitomising the growing significance of boutique style hotels providing guests with individualised service. In terms of capacity, boutique hotels cannot compete with larger corporate properties. However, their expansion and continuing success is indicative of changing consumer preferences. Construction activity during 2004 has included the 469 room Promenade Hotel located within the Crown Casino complex and totals around 675 rooms.

Brisbane's robust hotel performance is expected to continue into the foreseeable future benefiting from major events such as the Rotary International Convention which was held in 2003 and brought in 15,000 international visitors. The growth in domestic self-drive tour markets, mentioned previously, is likely to encourage further growth in Queensland's Gold Coast. The introduction of Australian Airlines to Cairns in October 2002 produced positive results with improved links to the Asia Pacific region, though schedules have now extended to Sydney and Melbourne, thus neutralising some of the initial advantage that was gained by the northern gateway. The network of direct connections from Cairns to Asian cities provides an ongoing boost to demand. Growth in demand is expected with limited new room supply envisaged in the near future.

In Adelaide, South Australia, additional room supply of 187 rooms for the March quarter 2003 caused short term market deceleration. In Western Australia, Perth recorded an increase in RevPAR of 13.7 per cent for the December quarter 2002, indicative that the market has recovered rapidly as air services are reinstated following the Ansett collapse. Increases in room supply in the form of serviced apartments are a continuing threat to the Perth

hotel market. As is the case in Sydney and Melbourne, Perth is experiencing an expansion of residential apartments in inner urban areas. This may alter the dynamics of property development with residential issues starting to exert some influence. Historically it has been issues of commercial property development which have been the dominant factor.

A significant increase in demand and static room supply in the Australian Capital Territory has produced positive results for the ACT tourist accommodation market in 2003. The market has been impacted negatively in the short term by the huge bushfires which occurred around the national capital during January 2003. Darwin continued to show negative trends during the first half of 2003. The launch of Australian Airlines services in 2002 which created new routes through Darwin should have boosted demand by mid-2003. The new north-south rail link between Darwin and Adelaide is providing a strong boost in the demand for leisure accommodation. Ongoing gas and oil exploration in the Timor Strait is likely to stimulate the corporate market.

In Tasmania a modest increase in room supply is expected for Hobart's tourist accommodation. Combined with strong domestic demand, the modest increase in supply should see Hobart improve its operational performance. This is a result of significant increases in motel and guesthouse accommodation capacity during 2001.

Future Prospects

Over the next five years, can we expect a repeat of the boom/bust mentality and behaviour of the past 15 years? Encouragingly, there is no single event on the scale of the Olympics with the likely prospect of spurring the type of building frenzy which occurred in the lead up to 1988 (the Bicentennial and Brisbane Expo) or 2000 (the Olympics). Since Melbourne is already facing an oversupply, the prospect of such a pattern occurring in Victoria in the lead up to the Commonwealth Games is less likely, thus avoiding any potential knock-on effect to other states. The State Government has emphasised the importance of staging an ongoing calendar of events and avoiding an over-emphasis on a single mega-event. If a more balanced and sustained approach were to be adopted towards investment throughout Australia, this would help to counteract the instability that has characterised international tourist markets between 2001 and 2003. It would also allow property owners a sufficient margin to make provision for refurbishment, thereby maintaining Australia's reputation for quality service and products.

The rise of serviced apartments in Australia to challenge the traditional hotel model has come later than was the case in North America. The trend is however now well established, with strong penetration into the corporate market. Other forms of accommodation are also emerging. They include boutique style properties, particularly in inner urban areas and in destinations within easy reach of the main cities. Spa and health-focussed properties are also booming. These include dedicated properties such as Hyatt Coolum, as well as established hotels which have embraced a health and spa dimension. The 16th release of the Tourism Forecasting Council in May 2003 expects international tourist arrivals to Australia to grow by nearly 21 per cent and domestic tourism room nights by 2 per cent over the next five years. (TFC 2003)

Matching development with changing consumer expectations and preferences will continue to be a major challenge for tourist accommodation developers. A notable example of attempts to address this challenge is evident in the Gold

Coast where some recent developments have exhibited a focus on theming in the Las-Vegas style. The Palazzo Versace Hotel introduced a classical Roman theme along with its association with up-market fashion. The Phoenician Hotel has pursued a middle-eastern theme. This trend towards fantasy is by no means dominant, but may signify a new phase of development beyond the main and established hotel brands offering a combination of corporate and resort ambience. This reflects recent trends in Las Vegas, USA and in the Genting Highlands, Malaysia, where the main trend is away from gaming but towards family resorts. Looking ahead, it is too early to predict with any confidence that Australia will move beyond the boom/bust mentality which has prevailed for so long. However, as has been evident for this paper, the dynamics are changing with a range of influences becoming evident.

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Table 1
International and Domestic Market Characteristics

Characteristics	International 2002	Domestic 2001-2002
Number of Arrivals/Trips	4.8 million	75.0 million
Average Number of Nights per Visit/Trip	23.9 nights	3.8 nights
Number of Visitor Nights	115.4 million	298.7 million
Number of Nights in Hotels, Motels and Guesthouses	18.7 million	72.1 million
Proportion of Total Nights in Hotels, Motels and Guesthouses	16.2%	24.1%

Source: Australian Bureau of Statistics

Figure 1
Value of Completed Tourist Accommodation Buildings
(Projects valued at AU\$50,000 or more)



Note: Includes hostels, boarding houses, guesthouses, and holiday apartment buildings. Excludes the value of land and landscaping

Source: Australian Bureau of Statistics

Table 2
Hotels, Motels And Guesthouse Establishments and Rooms In States And Territories

Location	<u>Hotels</u>						<u>Motels and Guesthouses</u>					
	2001		2002		Percentage Change		2001		2002		Percentage Change	
	Establishments	Rooms	Establishments	Rooms	Establishments	Rooms	Establishments	Rooms	Establishments	Rooms	Establishments	Rooms
New South Wales	201	25,001	198	23,855	-1.5%	-4.6%	990	32,929	979	32,109	-1.1%	-2.5%
Victoria	130	12,424	130	12,488	0.0%	0.5%	497	15,445	495	15,597	-0.4%	1.0%
Queensland	169	20,822	168	20,639	-0.6%	-0.9%	520	18,647	508	18,209	-2.3%	-2.3%
South Australia	61	4,083	62	4,362	1.6%	6.8%	144	5,170	145	5,232	0.7%	1.2%
Western Australia	129	9,464	128	9,438	-0.8%	-0.3%	124	5,561	126	5,579	1.6%	0.3%
Tasmania	53	2,900	54	2,867	1.9%	-1.1%	49	1,646	55	1,801	12.2%	9.4%
Northern Territory	23	1,976	23	2,012	0.0%	1.8%	49	3,187	47	3,185	-4.1%	-0.1%
Australian Capital Territory	15	1,904	14	1,855	-6.7%	-2.6%	27	1,845	27	1,853	0.0%	0.4%
AUSTRALIA	781	78,574	777	77,516	-0.5%	-1.3%	2,400	84,430	2,382	83,565	-0.8%	-1.0%

Source: Australian Bureau of Statistics

Table 3

**Performance Indicators For Hotels, Motels and Guesthouses
2000-2001 and 2001-2002**

	2000-2001	2001-2002	Change on Previous Year (%)
Revenues A\$ ('000)	2,446,909	2,442,948	-0.2%
Room Nights Sold ('000)	17,543	17,768	1.3%
Average Annual Occupancy Rate (%)	61.6	62.6	1.6%
Average Room Rate (A\$)	139.5	137.5	-1.4%

Source: Australian Bureau of Statistics

Table 4
Hotel Market Analysis 2002

	TOTAL	LUXURY Over \$170	FIRST CLASS \$120- \$170	ECONOMY Under \$120
NATIONALITY OF GUESTS	%	%	%	%
Domestic	64.0	57.4	67.8	63.7
International	36.0	42.6	32.2	36.3
Total	100.0	100.0	100.0	100.0
COUNTRY OF ORIGIN				
USA & Canada	6.4	16.7	6.1	3.6
South & Central America	0.2	0.5	0.1	0.3
Europe & United Kingdom	8.7	13.5	6.5	8.5
Asia	13.4	11.1	10.0	15.9
Africa & Middle East	1.4	1.1	2.7	0.9
Australia	57.8	52.5	58.7	58.5
New Zealand	7.2	2.8	10.1	7.0
Other (including Airline Crew)	4.9	1.8	5.8	5.3
Total	100.0	100.0	100.0	100.0
MARKET MIX				
Business Traveller	31.8	43.1	37.3	25.7
Tourists / Leisure FIT	32.7	33.3	26.1	35.9
Tour Groups	14.2	5.5	11.2	18.3
Meeting Participants	6.7	8.0	9.4	4.9
Government	4.6	2.6	3.4	5.8
Airline Crew	4.7	2.2	5.2	5.1
Other	5.3	5.3	7.4	4.3
Total	100.0	100.0	100.0	100.0
AVERAGE LENGTH OF STAY				
Domestic	2.1	2.7	2.0	2.0
International	1.9	2.1	1.8	1.8
ADVANCE RESERVATIONS				
Direct Inquiry (by guest)	31.8	31.9	28.2	33.7
Own Reservation System	16.3	13.2	14.6	17.9
Independent Reservation System	2.7	2.1	2.2	3.1
Travel Agent	15.4	15.3	18.0	14.0
Tour Operator	13.4	11.3	12.4	14.5
Hotel Representative	4.0	5.6	4.2	3.6
Transportation Company	2.8	1.6	1.2	3.9
Property's Web Site	1.9	2.7	1.7	1.8
Other Internet Site	1.7	3.8	1.3	1.3
Global Distribution System (GDS)	10.0	12.5	16.2	6.2
Total	100.0	100.0	100.0	100.0
OTHER GUEST STATISTICS				
Percentage of Repeat Guests	31.5	34.7	40.8	25.4
Average Room Density	1.5	1.4	1.4	1.6

Source: Hotel Industry Survey of Operations' 18th Edition, Horwath Asia Pacific

Table 5
Departmental Revenues and Expenses, 2002

AMOUNTS PER AVAILABLE ROOM	TOTAL		LUXUR Over \$170		FIRST CLASS \$120 - \$170		ECONOM Under \$120	
Average Size of Property (Rooms)	223		251		271		188	
Average Occupancy	69%		66%		70%		69%	
Average Daily Rate	\$130		\$230		\$143		\$95	
Department Revenues	\$	%	\$	%	\$	%	\$	%
Rooms	32,184	61.0	53,796	60.4	35,820	57.3	24,213	65.1
Food & Beverage	17,645	33.5	28,506	32.0	23,547	37.6	11,312	30.4
Telecommunications	954	1.8	2,290	2.6	1,014	1.6	555	1.5
Other Operated Departments	1,235	2.3	2,819	3.2	1,282	2.0	779	2.1
Rentals & Other Income (Net)	704	1.3	1,623	1.8	890	1.4	348	0.9
Total	52,722	100.0	89,034	100.0	62,553	100.0	37,207	100.0
Department Expenses								
Rooms	11,027	34.3	18,140	33.7	11,802	32.9	8,644	35.7
Food & Beverage	14,771	83.7	24,253	85.1	19,404	82.4	9,538	84.3
Telecommunications	685	71.8	1,356	59.2	775	76.4	451	81.3
Other Operated Departments	852	69.0	2,129	75.5	924	72.1	464	59.6
Total	27,335	51.8	45,878	51.5	32,905	52.6	19,097	51.3
GROSS OPERATING INCOME	25,387	48.2	43,156	48.5	29,648	47.4	18,110	48.7
Indirectly Allocated Operating Expenses								
Administrative & General	4,207	8.0	7,301	8.2	5,003	8.0	2,909	7.8
Marketing	2,442	4.6	5,239	5.9	2,618	4.2	1,577	4.2
Utility Costs	1,322	2.5	1,566	1.8	1,547	2.5	1,126	3.0
Property Operation & Maintenance	1,981	3.8	3,083	3.5	2,177	3.5	1,568	4.2
Total	9,952	18.9	17,189	19.3	11,345	18.1	7,180	19.3
Income Before Mgt Fees & Fixed Costs	15,435	29.3	25,967	29.2	18,303	29.3	10,930	29.4
Management Fees (Base + Inc.)	1,043	2.0	2,048	2.3	1,204	1.9	676	1.8
Income Before Fixed Costs	14,392	27.3	23,919	26.9	17,099	27.3	10,254	27.6
<i>Payroll and Related Expenses</i>	<i>19,407</i>	<i>36.8</i>	<i>33,435</i>	<i>37.6</i>	<i>22,977</i>	<i>36.7</i>	<i>13,540</i>	<i>36.4</i>

Note: Expense ratios to sales for departmental expenses are based on their respective departmental revenues.
All other expense ratios to sales are based on total revenue.

Source: Hotel Industry Survey of Operations' 18th Edition, Horwath Asia Pacific

Table 6
**Tourist Accommodation Performance in
Key Australian Destinations, 2002**

City	Occ	% Change	ADR	% Change	RevPAR	% Change
Sydney	72.2%	6.0%	\$139.05	-5.0%	\$100.43	5.5%
Melbourne	69.0%	-3.8%	\$135.22	-8.0%	\$93.30	-4.5%
Brisbane	72.6%	3.1%	\$101.75	1.8%	\$73.85	4.9%
Gold Coast	65.9%	2.8%	\$98.58	1.5%	\$64.99	4.3%
Cairns	66.2%	1.5%	\$100.01	1.9%	\$66.25	3.5%

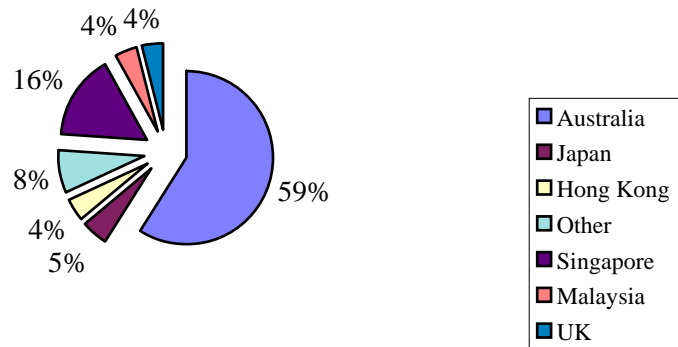
Source: ABS and Jones Lang LaSalle Hotels

Table 7
Top 10 Tourist Accommodation Owners, 2002

Owner	Rooms (No.)	Properties (No.)
Tourism Asset Holdings Ltd	5,104	39
Grand Hotel Group	3,255	25
Thakral Holdings Limited	2,608	10
Six Continents Hotels & Resorts	2,591	12
Stamford Land Corporation Limited	2,002	9
General Property Trust (GPT)	1,932	5
Carlton Hotels	1,461	5
Principal Hotel Group (formerly BT Hotel Group)	1,434	4
Travelodge	1,355	8
Daikyo Australia Pty Ltd	1,273	5

Source: Jones Lang LaSalle Hotels

Figure 2
Origin of Australian Tourist Accommodation Owners, 2002



Source: Jones Lang LaSalle Hotels

Table 8
Top Ten Tourist Accommodation Operators, 2002

Ranking		Management Company	Australian Properties	Rooms Under Management
2002	2001			
1	1	Accor Asia Pacific Corporation (AAPC)	95	15,009
2	2	Six Continents Hotels & Resorts	27	6,062
3	4	Starwood Hotel & Resorts	13	4,140
4	3	Rydges Hotels & Resorts	22	4,097
5	8	Pacific international Hotels	22	3,045
6	6	Hilton Hotels of Australia	8	2,769
7	5	Touraust Hotels Pty Ltd	29	2,656
8	9	Mirvac Hotels	20	2,499
9	7	Hyatt Hotels & Resorts	8	2,498
10	10	Stamford Hotels & Resorts Pty Ltd	10	2,002

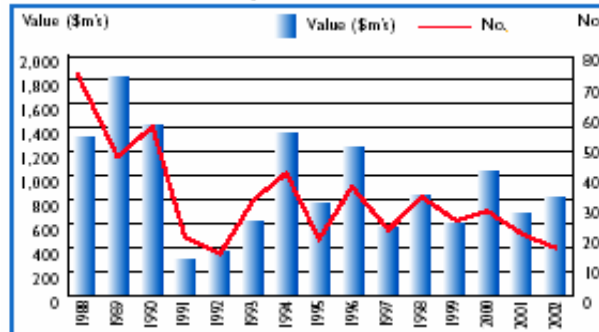
Source: Jones Lang LaSalle Hotels

Table 9
Additions to the Supply of Tourist Accommodation in Major Destinations (Apr '03)

Destination	Rooms			
	Under Construction	% Increase	Proposed	% Increase
Sydney	0	0.0%	630	3.4%
Melbourne	884	6.3%	194	1.3%
Brisbane	0	0.0%	135	2.0%
Gold Coast	0	0.0%	760	5.8%
Cairns	142	2.1%	272	3.8%
Total	1,026	1.7%	1,991	3.3%

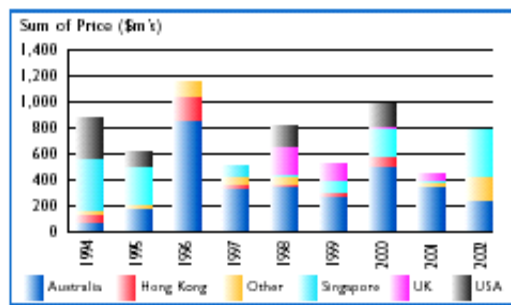
Source: Jones Lang LaSalle Hotels

Figure 3
Major Hotel Transactions 1988 - 2002



Source: Colliers International Australia

Figure 4
Origin of Purchasers of Major Hotels by Value



Source: Colliers International Australia