This report includes future modelling of the Sydney accommodation market. As with any future looking modelling, future projections have been based on historical data and relationships between various data points as well as the best current understanding of likely future events. As such, future estimates of demand, supply and pricing of future accommodation rooms in Sydney will be imprecise.

This report has been prepared diligently and based on the best available information, however, interpretation of the results should be seen as general guidance and should not be ascribed a greater expectation of accuracy than would be the case with any other similarly prepared forecast for the future.
EXECUTIVE SUMMARY

Sydney needs more hotel rooms and the market will naturally deliver these rooms through existing dynamic forces of supply, demand and price. The current hotel market in Sydney is performing well, with increases in occupancy and room rate. In time, these forces will reach a natural point that will trigger investment in new properties.

TAA recommends annual hotel supply increases between 150-550 or 5,000 rooms by 2020 will allow for market expansion, capture future demand and allow for a sustainable hotel sector in Sydney. Supply increases above these limits will see declines in occupancy and room rates, thereby destroying the recent gains the industry has made and reverting back to a boom and bust development cycle. Given the barriers to development of hotels in Sydney, Government should consider the role of incentives to encourage room supply increases and ensure that any intervention in the market is targeted, well-founded and does not over stimulate the market. Considerations to specify the tourism use of Government held property and encourage a mix of uses in developments may prove effective. Any incentives must be thoroughly explored to ensure that they will deliver the anticipated results and not provide negative impacts in the market. Close monitoring of the market and rigid mechanism to ensure any inducements do not overstimulate the market are required.

Following examples from within Australia and overseas, the best way for Government to encourage investment in new hotels is by providing a stable operating environment that is conducive to investment. In Melbourne and Singapore (two successful hotel markets), there is a balanced approach to the hotel sector that includes a focus on marketing and events as well as investments in demand drivers (i.e. strategic infrastructure that will generate demand). This approach has proven effective in delivering new supply of hotel rooms on a consistent and sustainable basis.

By providing strong support for marketing and investment in demand drivers as well as ensuring the local market is not overstimulated, Government can create the type of environment that will encourage investment. In this environment, consistent and sustainable increases to room supply will be made, as the experience of other markets proves.

Government and the tourism industry need to ensure that lessons are learnt from Sydney’s history and past mistakes are not repeated that can devastate the market, destroy investor confidence and impair property values of such a critical component of the tourism industry. Over the last decades, there have been two supply shocks in the Sydney hotel market in which government played a key role. In both instances, the bust that followed the boom drove investment away from Sydney and these past shocks actually contribute to the recent lack of investment in new hotel rooms.

If Government incentives are not targeted, they have the potential to create another artificial hotel development boom, which could once again lead to declines in investor confidence. Through discouraging future investment in hotels, Sydney could lose $189 million in annual investment or a total of $1.7 billion of investment by 2020. Similarly, there is a potential loss of almost 3,700 jobs and $327 million in Gross Regional Product to the Sydney regional economy.

Tourism Accommodation Australia (TAA)

Tourism Accommodation Australia (TAA) is the newly established division of the Australian Hotels Association representing the interests of the substantial operators in the Australian accommodation industry. TAA is the representative organisation for owners, operators and managers of hotels, motels and serviced apartments. TAA members include over 600 substantial owners and operators.

The Sydney accommodation sector:
1. Employs 14,600 people, which is 14% of total tourism employment in Sydney.
2. Generates $1.3 billion in Gross Regional Product, which is 17% of Tourism GRP in Sydney.
3. Accounts for $2.2 billion, or 20% of total visitor expenditure.

Accommodation is a key component of the tourism sector value chain in an industry worth over $30 billion annually to the national economy.
OVERVIEW OF SYDNEY HOTEL INDUSTRY

Current Performance

The Sydney hotel market is the largest in the country and has performed well in recent years, with occupancy, average daily rate (ADR) and revenue per available rooms (RevPAR) all increasing from 2006. Occupancy rates in the Sydney hotel market have been particularly high (above 80%) in recent years, which represent the highest occupancy rates achieved in the market for more than two decades.

Current & Historic Supply Overview

Despite a strong performance, there has been very limited hotel room supply growth in Sydney, with only 325 hotel rooms added since 2006. One factor contributing to the lack of investment would be the limited level of real growth (adjusted for inflation - 2.9%) in ADR and RevPAR. Additionally, on a global scale, Sydney is often under priced, indicating that prices will need to increase further to provide enough stimulus to trigger future investment.

Table 1: Sydney Hotel Market Statistics, Year Ending September

<table>
<thead>
<tr>
<th>YEAR ENDING SEPTEMBER</th>
<th>ROOMS (NO.)</th>
<th>ROOM NIGHTS SOLD (NO.)</th>
<th>OCCUPANCY RATE (%)</th>
<th>ADR ($)</th>
<th>REVPAR ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>19,443</td>
<td>5,487,343</td>
<td>77.4%</td>
<td>$182</td>
<td>$141</td>
</tr>
<tr>
<td>2007</td>
<td>19,704</td>
<td>5,860,030</td>
<td>81.6%</td>
<td>$196</td>
<td>$160</td>
</tr>
<tr>
<td>2008</td>
<td>19,787</td>
<td>5,891,590</td>
<td>81.4%</td>
<td>$203</td>
<td>$165</td>
</tr>
<tr>
<td>2009</td>
<td>19,880</td>
<td>5,716,239</td>
<td>78.9%</td>
<td>$188</td>
<td>$148</td>
</tr>
<tr>
<td>2010</td>
<td>19,906</td>
<td>6,198,202</td>
<td>85.4%</td>
<td>$189</td>
<td>$162</td>
</tr>
<tr>
<td>2011</td>
<td>19,768</td>
<td>6,212,004</td>
<td>86.1%</td>
<td>$204</td>
<td>$176</td>
</tr>
<tr>
<td>Total Growth 2006-2011 (%)</td>
<td>1.7%</td>
<td>13.2%</td>
<td>11.2%</td>
<td>12.1%</td>
<td>24.8%</td>
</tr>
<tr>
<td>Total Growth 2006-2011 (No.)</td>
<td>325</td>
<td>724,661</td>
<td>8.7%</td>
<td>$22</td>
<td>$35</td>
</tr>
</tbody>
</table>

Note: (a) Occupancy rates are expressed as percentage point change.
Source: ABS (2011)

Table 2: International Price Comparison, Selected Cities, 2011

<table>
<thead>
<tr>
<th>CITY</th>
<th>3 STAR</th>
<th>4 STAR</th>
<th>5 STAR</th>
</tr>
</thead>
<tbody>
<tr>
<td>New York</td>
<td>$230</td>
<td>$279</td>
<td>$538</td>
</tr>
<tr>
<td>Singapore</td>
<td>$146</td>
<td>$207</td>
<td>$346</td>
</tr>
<tr>
<td>London</td>
<td>$143</td>
<td>$208</td>
<td>$360</td>
</tr>
<tr>
<td>Tokyo</td>
<td>$118</td>
<td>$220</td>
<td>$476</td>
</tr>
<tr>
<td>Sydney</td>
<td>$109</td>
<td>$166</td>
<td>$273</td>
</tr>
<tr>
<td>Shanghai</td>
<td>$60</td>
<td>$96</td>
<td>$221</td>
</tr>
</tbody>
</table>

Note: Prices converted from Euro to Australian Dollar using average exchange rate for 2011 (0.7696).

Historically there have been two major expansions to industry supply, both of which included Government incentives, where a significant number of rooms were added to the market in a very short period of time.

These supply shocks contributed to significant downturns in occupancy, ADR and RevPAR, which took many years before the market could recover and normalise. These market crashes have negatively impacted investment and investor confidence in Sydney. These supply shocks (and the downturns that followed) are predominantly responsible for the limited growth in hotel investment over the last five years as investors remain apprehensive about the Sydney market.

1 Unless otherwise stated, this paper considers the Sydney hotel market to include hotels, motels and serviced apartments within the City of Sydney local government borders.
Both of these shocks were influenced in part by Government policy and action with major land releases in the late 1980s and early 1990s and the floor space ratio (FSR) bonus leading up to the Olympic Games in 2000. These supply shocks were also preceded by increases in occupancy, ADR and RevPAR, which is very similar to the current market conditions. The Sydney hotel market must learn from the lessons of history and avoid another supply led shock to the market.

Figure 1: Historic Room Supply, ADR and RevPAR, City of Sydney

![Figure 1](image)

Source: AECgroup, Jones Lang LaSalle (2011a)

Figure 2: Historic Occupancy Rates, ADR and RevPAR, City of Sydney

![Figure 2](image)

Source: AECgroup, Jones Lang LaSalle (2011)
GROWING THE SYDNEY HOTEL INDUSTRY

The hotel marketplace incorporates functions of supply, demand and price. A deep appreciation of all three variables is required to accurately understand and appreciate likely future movements in the market.

Hotel Supply

It is estimated there are nearly 20,000 hotel rooms within Sydney, with another 1,500 rooms to be added by 2015. This increase is equivalent to the total rooms added to the Sydney hotel market over the last eight years, and represents 7% of current supply.

Table 4: Future Hotel Supply, City of Sydney, 2011

<table>
<thead>
<tr>
<th>HOTEL</th>
<th>LOCATION</th>
<th>ROOMS</th>
<th>RATING</th>
<th>EXPECTED COMPLETION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Meriton Haymarket</td>
<td>CBD South</td>
<td>247</td>
<td>4 Star</td>
<td>Q4'11</td>
</tr>
<tr>
<td>The Darling Hotel</td>
<td>Pyrmont</td>
<td>171</td>
<td>5 Star</td>
<td>Q4'11</td>
</tr>
<tr>
<td>QT State Theatre</td>
<td>CBD</td>
<td>196</td>
<td>4.5 Star</td>
<td>Q4'12</td>
</tr>
<tr>
<td>Novotel Darling Harbour</td>
<td>Darling Harbour</td>
<td>96</td>
<td>4 Star</td>
<td>2013</td>
</tr>
<tr>
<td>Barangaroo</td>
<td>Darling Harbour</td>
<td>250</td>
<td>5 Star</td>
<td>2015</td>
</tr>
<tr>
<td>Darling Harbour South</td>
<td>Darling Harbour</td>
<td>500+</td>
<td>Mix</td>
<td>2016</td>
</tr>
</tbody>
</table>

Source: Jones Lang LaSalle Hotels (2011), Deloitte (2011)

Visitor Demand

Two future demand profiles have been considered, including Tourism Research Australia (TRA) forecasts and NSW Government goal of doubling tourism expenditure by 2020. The TRA projections are based on the Tourism Forecasting Committee’s future expectation of domestic and international visitation growth of 1.8% per annum until 2020. Projections from the NSW Government target have been calculated to determine the required number of visitors staying in hotels to double tourism expenditure. Adopting the current mix and spending of all visitors to the City of Sydney as a base, that equates to a 4.1% per annum increase in visitors staying in hotels through 2020.

Historical Growth in Demand

Historically, the Sydney hotel market has not experienced long-term growth at or near the target rate of 4.1% per annum. According to TRA, between 2000-2011, there has been an average annual decline in visitor nights spent in hotels of 1.4%. The strongest performance of the industry in recent time saw 2.8% average annual growth between 2004 and 2010. Based on past performance, the NSW Government target may not be attainable. Dramatic action and significant investment in infrastructure, events and promotion will be required for a target of 4.1% average annual growth to be achieved.
The growth targets of the NSW Government will require investments in strategic tourism infrastructure, marketing and events. In order to achieve the identified goals (which are considerably higher than expected demand) considerable efforts are required to develop key infrastructure, such as the Sydney Convention, Exhibition and Events Centre, a dedicated cruise ship terminal, iconic attractions and the recruitment of major events. Solutions to Sydney Airport and other transport infrastructure challenges will also be required.

In order to achieve growth, a strategic, long-term tourism approach is needed, with considered marketing initiatives and infrastructure investments. Without considerable action and investment, there is no realistic expectation that future demand will increase beyond current forecasts.

**Sustainable Supply Increases to Meet Demand**

AECgroup’s Australian Tourism Accommodation Model (AusTAM) has been used to identify the future hotel market conditions in Sydney under both demand scenarios (i.e. TRA and NSW Government targets). AusTAM is a multi-equation, structural model that captures economic factors within the tourism accommodation market and considers supply, demand and price in a dynamic setting.

The figures below highlight various supply scenarios (Scenario 1, 2 and 3), which are based on ADRs (Average Daily Room Rates) that generate a 9%, 12% and 15% return on investment. It should be noted that this assessment only considers the operation of an existing property and does not consider any financing expenses. As such, the estimated 9%, 12% and 15% return on investment is based solely on estimated average sale / purchase prices in recent hotel transactions. A real return on investment would be lower. Developers will typically require a return on investment in excess of 20% when considering new development projects and investors generally, and very broadly, seek an approximate 11% return when considering purchases of existing properties.
These results highlight sustainable levels of hotel room increase in the City of Sydney for two distinct demand profiles. The results are not meant to dictate supply increases in the market but rather provide general guidance regarding future increases in supply (under different demand profiles). These increases in supply allow for the industry to operate in a profitable and sustainable manner. Supply increases above these levels will result in falls in occupancy, ADR and RevPAR, which could impair the market resulting in economic loss and negatively impact investor confidence. This will drive away future investment and impede the ability of the Government to achieve its target of doubling tourism expenditure by 2020.
Table 5 highlights average annual increases in room supply under both demand profiles. This data provides guidance on the levels of annual increase that can occur without impairing sustainability of the hotel industry (i.e. supply increases between 145-549 rooms per year or a maximum of 4,944 rooms by 2020).

Table 5: Future Room Supply, City of Sydney

<table>
<thead>
<tr>
<th>TRA DEMAND PROFILE</th>
<th>NSW GOVERNMENT DEMAND PROFILE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>SCENARIO 1</td>
</tr>
<tr>
<td>Average Annual Increase</td>
<td>549</td>
</tr>
<tr>
<td>Total Increase 2012-2020</td>
<td>4,944</td>
</tr>
</tbody>
</table>

Source: AECgroup

Naturally, under NSW Government demand projections there is increased scope for hotel development in Sydney. However, if the growth profile of these projections (4.1% average annual increase in demand) is not met, then the potential to over supply the market exists (i.e. demand projections must be met in order to provide for a larger increase in hotel supply).

At the same time, the estimated average annual increase in hotel supply should not be aggregated if the threshold is not met in any one given year. While limited supply growth in any one year may provide some stimulus to increase hotel rooms above the 550 level in the following years, there are limits to the single year increases. AECgroup modelling indicates that a single year increase in excess of 1,600-1,800 rooms would cause considerable drops in market indicators.
CHALLENGES FACING THE SYDNEY HOTEL INDUSTRY

There are three key challenges to expanding the Sydney Hotel Industry:

- **Demand**: Ensuring that the number of visitors to Sydney and their length of stay continue to increase through strong marketing as well as development of events and conferences.
- **Infrastructure and Product**: An investment in catalytic infrastructure (i.e. convention centre, cruise ship terminal, iconic attractions and transportation infrastructure) is required to drive demand and growth in visitors long term.
- **Supply**: There is a need to ensure that new hotel rooms can be developed in Sydney in a consistent, profitable and sustainable manner.

**Demand for Hotels**

Since 2000, visitation to Sydney has declined at an average annual rate of 1.7%. For hotels, this decrease in overall market visitation has translated to an average annual decrease of visitor nights spent in hotels of 1.4%.

![Figure 6: Total Visitors to Sydney](source)

Future increased visitation to, and length of stay in Sydney, will be critical to encouraging investment in new hotels as well as driving achievement of the NSW Government goal to double tourism expenditure by 2020.

![Figure 7: Visitors Staying in Hotels](source)
Infrastructure and Product Development

Sydney is already an iconic Australian destination, with 43% of all inbound international visitors travelling through Sydney. The city is the gateway to Australia. Its Opera House and Harbour Bridge are an integral part of the “Australian brand”.

Development of new infrastructure and product is required to drive demand and grow visitation further. Convention centres, cruise ship terminals, iconic attractions and transportation infrastructure will increase visitors and ensure Sydney remains an iconic destination.

While the development of a new convention and exhibition centre for Sydney will provide economic benefits for the tourism industry, more can be done to drive demand in visitation through tourism infrastructure development, including:

- **Airport capacity**: the recent *Joint Study on Aviation Capacity in the Sydney Region* advises that by 2035, the capacity pressure around Sydney Airport will lead to major impacts and costs as well as make the airport unable to meet demand for new services. By 2020, all slots on weekday mornings between 6am and noon as well as afternoon slots between 4pm and 7pm will be fully allocated.

- **Transport infrastructure**: the recent *Joint Study on Aviation Capacity in the Sydney Regions* also states that from 2012, the capacity of existing road junctions at the entrance to the domestic terminal precinct will be exceeded, acting as a cap on visitor growth. Additionally, improving transport access and systems around the City and each of its tourism precincts will improve the efficient movement of visitors.

- **Cruise Shipping**: the continued growth of cruise shipping in Australia hinges on the Sydney Harbour being available to accommodate mega-liners. By 2015, some 85% of cruise ships will be too large to pass under the Sydney Harbour Bridge. A new dedicated cruise ship terminal east of the Bridge would assist in driving visitation to Sydney.
CASE STUDY: MELBOURNE – THE IMPORTANCE OF HAVING A BALANCED APPROACH

The Melbourne hotel market has had a unique experience in recent times. As a relatively large market (second largest behind Sydney), considerable room supply was added between 2006-2011, equating to over 15% of supply or almost 2,200 rooms. At the same time, the market was able to maintain strong occupancy that fluctuated between 77%-81% with simultaneous ADR growth of 17.5% (or 3.3% per annum).

This has been achieved through a balanced approach to the development of the hotel industry, working across supply, demand (i.e. focused activities on marketing and events) and investments in key infrastructure.

Figure 8: Historic Room Supply, ADR and RevPAR, Melbourne City

Source: Jones Lang LaSalle (2011)
Supply of New Hotel Rooms

The development of new, stand-alone, greenfield hotel properties in Sydney is difficult. Hotels function differently to other asset classes in that the capital value of a hotel is dependent on the business operating within the property more than on the property itself. There are numerous barriers to development of hotels in Sydney, including:

DEVELOPMENT BARRIERS

• **Competition with Other Land Uses**: hotels demand location on prime real estate. The land is typically highly sought after for other land use types (such as residential, office or mixed use), which further generally provide higher development returns and are easier to finance.
• **Increasingly High Land Costs**: given the characteristics required for a successful hotel site, land costs are generally high and the competition for sites with other land use types exacerbates the situation.
• **Access to Financing**: it is often more difficult to secure financing for hotel developments compared with other property development projects (such as residential or office). Developers can more readily obtain finance for non-hotel projects through residential pre-sales or office/retail lease pre-commitments. In order to access debt financing, valuations are required. Hotel valuations are very sensitive to future supply increases. This data is often the only future variable that valuers can identify with any certainty.
• **High and Increasing Construction Costs**: construction costs have soared across Australia over the last decade, as a result of strong demand for construction materials and skilled construction labourers. Both have increased the cost of building hotels. Hotels generally cost more (on a sqm basis) to build than competing land uses. In order to comply with the Building Code of Australia, hotels (as Class 3 buildings) must have additional amenity and safety features that are not required in a residential building (Class 2).
• **Development Timeframes**: there is a significantly long development and “ramp-up” lead time (minimum of 5-6 years) before hotels perform at normalised trading levels, resulting in increased investment pay back periods and capital costs. Residential or commercial projects can pay back investment and financing costs much more quickly by comparison.

OPERATIONAL BARRIERS

• **High Fixed Costs**: a large proportion of hotel operating costs are fixed (i.e. not increasing or decreasing relative to demand) and are generally higher than for other property developments (which in the main generate cash returns from lease rentals rather then via the variable results of an operating business in the case of hotels).
• **Tourism Infrastructure Investment**: hotels benefit greatly from investment in tourism infrastructure (e.g. convention centres, casinos, etc) that drive or induce demand for visitation and resultant accommodation. A lack of tourism infrastructure development can stymie hotel investment.
• **Revenue Volatility**: a very diverse range of factors influence demand for hotels and variability in demand can be considerable. Substantial revenue fluctuations result. Most of these factors tend to be macroeconomic in nature and cannot be influenced by the hotel industry.
• **Long-term Performance**: given historic volatility in Sydney’s market, hotels have produced a widely diverse group of results over the long run.

Naturally, as hotel trading and resultant indicators (i.e. occupancy, ADR and RevPAR) continue to increase, development feasibility of hotels will improve. While market dynamics alone may eventually trigger investment in new hotel properties, some jurisdictions are currently contemplating providing incentives to encourage hotel development in the short term.

Any government intervention into the market should be made in a careful and considered fashion so as not to over stimulate development and prejudice the market. Any government action should be taken as part of a balanced approach, focusing on supply, demand and infrastructure (to drive demand). Previous supply shocks in the Sydney market have required many years to properly absorb the new supply and enable properties to reach normalised trading levels and pre existing hotels to regain reasonable profitability.
Serviced Apartments and Class 2/3 Buildings

Serviced apartments are an important part of the overall accommodation mix in Sydney and comprise approximately 18% (nearly 6,000 rooms) of the supply within the Sydney Tourism Region. Serviced apartments have experienced strong growth in supply over the last 10-15 years, with the number of rooms more than doubling, while hotel room supply only increased by 36%.

This growth in serviced apartments over hotels is due to a combination of factors. Traditional hotels are a Class 3 building according to the Building Code of Australia, which requires different and additional safety and amenity features. Class 2 buildings, which often include serviced apartments, are more traditional residential dwellings that have different requirements. From a construction perspective, serviced apartments are less costly to build, thereby reducing one of the barriers for hotel development. Additionally, because serviced apartments can be easily transferred to residential units, they provide a less risky profile to financing organisations, making them easier to fund than traditional hotels. Serviced apartments can also be brought into and taken out of the room supply relatively easily, given their ability to transition to residential units. Finally, serviced apartments have a much lower operating costs basis, which provides further support increasing the feasibility of serviced apartments above traditional hotels.

Rapid increases or decreases in serviced apartment supply can destabilise the accommodation sector and we would recommend the strict enforcement of current zonings and building codes.
IMPORTANCE OF THE SYDNEY HOTEL INDUSTRY

Hotels and the accommodation sector provide considerable economic benefits to Sydney, including:

- Direct contribution to the economy.
- Unlocking of visitor expenditure.
- Flow-on effects and contributions to small businesses.

Hotels are critical economic infrastructure, not just for the tourism industry, but also for the whole economy. Directly, the accommodation sector employs 14,600 people in Sydney and generates $1.3 billion in Gross Regional Product. Indirectly, the benefits are far greater. Hotels are critical infrastructure within the tourism value chain and help to unlock visitor spending. Overnight visitor expenditure exceeds $10 billion (85% of total visitor expenditure) for the Sydney metropolitan region. On a per visitor basis, spending on accommodation accounts for 20% of total expenditure, leaving almost 80% of total visitor expenditure flowing through the rest of the economy. Some of the key sectors that receive this expenditure include retail trade, restaurants, recreation and transport services. These sectors are often dominated by small businesses.

As the Sydney hotel industry grows the economic benefits will flow in terms of employment, GRP, investment and visitor spending. However, if Government incentives create another artificial hotel development boom, there could be dire consequences. Through discouraging future investment in hotels, Sydney could lose $189 million in annual investment or a total of $1.7 billion of investment by 2020. Similarly, there is a potential loss of almost 3,700 jobs and $327 million in Gross Regional Product to the Sydney regional economy.

In order to maximise the considerable economic benefits from growth, it is essential there is sustainability across the Sydney hotel industry.
CONCLUSION AND RECOMMENDATIONS

A balanced approach to the hotel sector focused on supply, demand and infrastructure is a proven way of ensuring a vibrant hotel industry and tourism sector. Investing in critical tourism infrastructure to drive visitation as well as marketing initiatives with a focus on events and conferences will all assist in driving future demand for hotels. These efforts will also assist the NSW Government to achieve its goal of doubling tourism expenditure in the state.

In order to have a meaningful impact on encouraging growth in the tourism industry and the hotel sector in Sydney, a balanced approach is required. Efforts to encourage hotel supply must be closely coordinated with marketing efforts to boost visitation and key investments in strategic infrastructure to drive demand. Efforts focused solely on supply will fail.

The hotel sector is an important component of the tourism industry and contributes greatly to tourism and the overall economy. In order to ensure sustainable future hotel development, a stable environment conducive to investment needs to exist in Sydney. Historically, room supply shocks have had detrimental impacts on the market and required many years to return to normal trading levels. Each shock was preceded by increasing occupancy, ADR and RevPAR (similar to the current situation).

The hotel sector needs to grow in order to continue its important economic contribution to Sydney. However, it must grow in a manner that provides for the future sustainability of the industry and avoids the pitfalls of past supply side shocks.

Adding between 150-550 rooms per year (or a total of 5,000 rooms) by 2020 will allow for supply increases to meet anticipated demand and at the same time allow for a sustainable hotel industry. Increases above this level will provide little or no return on investment to the hotel industry. An increase in excess of 1,600-1,800 rooms in any one single year may also have detrimental impacts on the hotel industry.

Supply increases within this target range will ensure a sustainable industry in the future, which will also contribute to building a stable operating environment for hotels. Effectively managing and enforcing the discrepancy between Class 2 and Class 3 buildings, which allows serviced apartment rooms to transition into and out of the hotel market, can also provide greater levels of stability. The facilitation of this stable operating environment will act as a catalyst for future investment.

To secure the long term future of the Sydney hotel industry, TAA makes the following recommendations:

- Government should closely monitor the hotel market in Sydney in order to better understand dynamics of supply, demand and price. This monitoring will also allow for a better understanding of the development cycle and how best to encourage a long-term, sustainable operating environment for hotels as well as assist in avoiding situations of oversupply in the future.

- Government should adopt a balanced approach to supporting the hotel sector in Sydney, including efforts to encourage supply, increase demand through marketing (with a focus on events) and investments in strategic infrastructure in order to drive demand. Increases in demand are required for the broader tourism sector and the Sydney hotel sector to grow in the future.

- Government should consider the role of incentives to encourage hotel development and ensure that any intervention in the market is targeted, well founded and does not overstimulate the market. Considerations to specify the tourism use of Government held property and encourage a mix of uses in developments are likely to be the most effective incentives. Statutory incentives, such as a floor space ratio (FSR) bonus, are inefficient. Any incentives must be thoroughly explored to ensure that they will deliver the anticipated results and not provide any negative impacts in the market. The implementation of any incentives must be done in a responsible manner so as not to overstimulate the market. Through the close monitoring of the market, Government must remove inducements after sustainable supply levels of hotel rooms have been delivered (or committed) to the market. A robust mechanism for control and monitoring is required.

- Government should take steps to ensure building codes are strongly enforced and provide a level playing field across various property classes. Ensuring that Class 2 buildings do not easily transition in and out of the hotel room market supply or requiring higher standards of amenity and safety (as in Class 3 buildings) in serviced apartments would provide greater levels of stability in the hotel industry and provide for a fairer operating environment.
Further Information

The information in this document has been compiled from a comprehensive industry analysis undertaken by the AECgroup for TAA. Full copies of the report “Sustainable Hotel Development in Sydney” are available from TAA.