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IN FOCUS:
SOUTH AFRICAN HOTEL MARKET UPDATE

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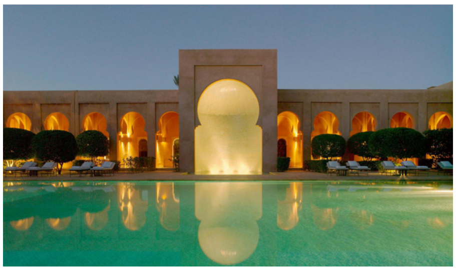


Introduction

The South African economy, like other emerging markets, has been impacted by several global challenges, with many of those lying outside its control. These include exchange rate fluctuations, the fall in commodity prices and a slowdown in the Chinese economy. This article highlights the macro factors impacting the South African hotel market. Over supply after the 2010 FIFA World Cup is well documented, unfortunately there were other influencers exacerbating the imbalance in supply and demand. Occupancy and average daily rate (ADR), in local currency, have now been growing in the main accommodation centres, signaling the worst may be behind us. But what should investors and operators be aware of when considering South Africa for their next hotel?

Economic Factors

South Africa's highest GDP growth in the past 5 years was 3.21% in 2011, up from 3.04% in 2010. In 2015 it was more modest at 1.2% and 2016 is forecast to be 0.7%. Inflation targeting is still the primary monetary policy with interest rates used to combat inflation irrespective of the cause of the price increases.

Growth (Annual %)	'10	'11	'12	'13	'14	'15
GDP growth	3.0	3.2	2.2	2.2	1.5	1.2
Inflation	6.4	6.7	5.5	6.0	5.8	5.9
Interest Rate Spread	3.1	3.2	4.1	4.0	5.0	4.2
Population Growth	1.4	1.5	1.5	1.5	1.6	1.6

Source: KNOEMA

The entry visa issues had an impact on visitor numbers. With the current Rand US$ exchange rate levels tourism numbers are expected to rise. However there have been reports of several families being denied access to ports of entry at airports, as they did not have the correct paperwork to enter the country.

Many operators enjoyed record visitors over the last few months; the Victoria & Alfred Waterfront in Cape Town had their busiest holiday season. Some hoteliers are taking advantage of the situation with huge rate increases. It is claimed some establishments increased rates by 30% over the past festive season, despite headline inflation remaining below 6%. They justify such increases by the fall in value of the Rand against leading currencies. The argument being, if the Rand has dropped more than 30% in value, the international guest still benefits if the price increase is less.

Unsurprisingly this tactic elicited an acrimonious reaction from wholesalers and locals alike. It is unlikely to be successful as visitors will be expecting to benefit from the devaluation of the Rand. A further negative impact of exchange rate based room rate increases is that a parallel market gets created wherein the domestic traveller is no longer able to afford to stay in local hotels.

The unprecedented current drought and heatwave has dealt a serious blow to the economy due to high food costs and the destruction of many crops and livestock. It has led to water shortages and rationing in many areas.

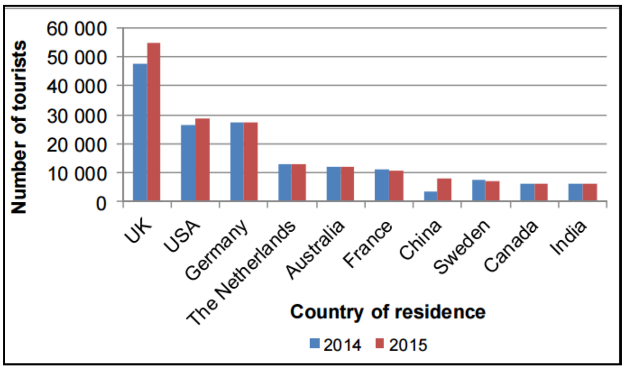
Eskom's electricity supply load-shedding also had a negative impact on the economy. Lost sales at retail outlets, work stoppages at factories and reduced manufacturing output have all resulted from the lack of certainty of power.

On the Tourism Front

South African Tourism, the marketing wing of the Department of Tourism, continues to do an important function of keeping the country top of mind when it comes to holidaymakers and business travellers.

The World Economic Forum (WEF) on Africa named Sub-Saharan Africa's top 10 countries in travel and tourism competitiveness, with South Africa taking the lead. The World Economic Forum's Travel and Tourism Competitiveness Index placed South Africa at position 48, an improvement of 12 positions in 24 months.

Top 10 Tourist Sources – Dec 2014/2015



Source: Statssa

According to the above table, tourists from the top ten overseas sources to South Africa, only the UK the USA and China showed an increase in the number of visitors in the 12-month period to December 2015 compared to the previous year. Tourists from China increased by the highest number during the same comparative period.

According to Euromonitor, based on international traveller statistics for 2014 Johannesburg is the 32nd most popular destination in the world. These two cities are by no means the only ones that have tourism assets. Each one of the other seven provinces has unique attributes that travellers find attractive.

International operators continue to enter this market and are bringing with them their full line-up of accommodation products. This is pointing towards a growing sophistication of the market for both local and international guests.

Big spenders continued to invest in 2015, with many new hotel developments and refurbishment projects being finalized. Tsogo Sun took ownership of the Liberty Life hotel portfolio last year for an undisclosed sum, while Sun International announced its intention to purchase competitor Peermont Global for R9.4 billion. The latter is pending Competitions Commission approval.

Global chain groups are still bullish about entering the South African hotel market. South Africa is getting its first Marriott branded properties. Marriott International has signed two new properties in South Africa in partnership with property developers the Amdec Group. The 150-room Johannesburg Marriott Hotel Melrose Arch and the 200-unit Marriott Executive Apartments Johannesburg Melrose Arch will be located in the Melrose Arch precinct.
Carlson Rezidor, one of the most dynamic hotel groups worldwide, announced the very first Radisson Red in Europe, the Middle East and Africa: the group's new upscale lifestyle select brand launches in Cape Town, South Africa.

The Radisson Red Hotel V&A Waterfront will open in late 2016 and be located at the V&A Waterfront.

"Despite the global financial crisis and no longer being Africa's largest economy, South Africa is still the number one destination in Africa for foreign direct investment with no indication that will change" according to the Department of Trade and Industry of South Africa.

2016 Outlook

Gross domestic product growth is expected to come in at less than 1% in 2016 whilst interest rates are expected to rise by at least 0.75% by year end to 6.8%. Looming debt ratings and subsequent downgrading of South Africa's investment status have led both politicians and business captains to take action.

With China scaling down manufacturing and export activities this opens up an opportunity for African countries to fill this space. After all it is commodities from some of these countries that have helped China cement its place as the second largest economy in the world.

Foreign direct investment into South Africa is expected to continue at a consistent pace.

Japan has adopted negative interest rates as a macroeconomic policy stance in order to stimulate economic activity in that country and to escape an endemic recession. This could spur investors into that country to look for returns elsewhere in countries that still promise positive interest rates, such as South Africa.

The highest impact of the strict entry visa rules was felt mostly by families travelling with children. The Home Affairs and Tourism Departments have now unveiled a new passport for underage children which contains the names of both parents. This therefore eliminates the need for parents to obtain an abridged certificate for each child they travel with into South Africa. The benefit to foreign visitors is that now they can reduce significantly the time it takes to complete their travel arrangements.

The five-yearly Municipal elections are due to take place in 2016 and once they are over they will provide policymakers with ample focus to take the country's economy forward.

Conclusion

While the past 12 months have been some of the most economically turbulent in the history of modern-day South Africa, the future is starting to brighten.

There are challenges ahead and with all investments in Africa, hotels being no exception, there will be potholes on the gravel roads; not the smooth tarmac of Europe and the US. However, the rewards, once you miss those potholes are substantial.

About HVS

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The **Cape Town** office focuses on the whole African continent. We have worked in 24 different African countries and both the main established and new markets, advising on existing and proposed hotels and resorts.

About the Authors

Tshepo Makhudu is a senior consultant in our Cape Town office. He has many years of property industry experience and has held employment at leading property, banking and telecommunications multinational institutions. Notably he worked in the hospitality industry during the most vibrant era of the industry in South Africa, with a responsibility for the efficient delivery of hotel and casino development projects. Tshepo studied commerce and property development at leading universities in South Africa and received leadership training in the USA.

Tim Smith, MRICS is Managing Partner of our Cape Town office, focusing on assignments across the African continent. He graduated from De Montfort University with a degree in Estate Management and has worked as a chartered surveyor since 1995, specializing on the valuation and sale of hotels and other leisure property throughout the EMEA region.

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