



Hotel economics

Supplying hotels in Dubai will be more challenging than securing the demand

Ambitious growth targets

In November 2013 the Department of Tourism and Commerce Marketing (DTCM) in Dubai announced the need to raise the number of hotel rooms available significantly in order to meet the growth in tourism envisaged by 2020. The total room stock is set to double by 2020 to around 160,000 rooms from the number of rooms available in the market at the end of 2013. As part of its Tourism Vision 2020 the DTCM is targeting 20 million visitors by 2020, a substantial rise from just over 11 million visitors in 2013. The doubling of the room stock from its current base of approximately 68,000 hotel rooms and 14,000 hotel apartment rooms will present a host of challenges to the market. Most industry players have raised concerns over the ability of the market to absorb such a high rate of increase in room supply. But it is not only the quantum of rooms that is the issue as much as delivering this high number in the targeted timeframe.

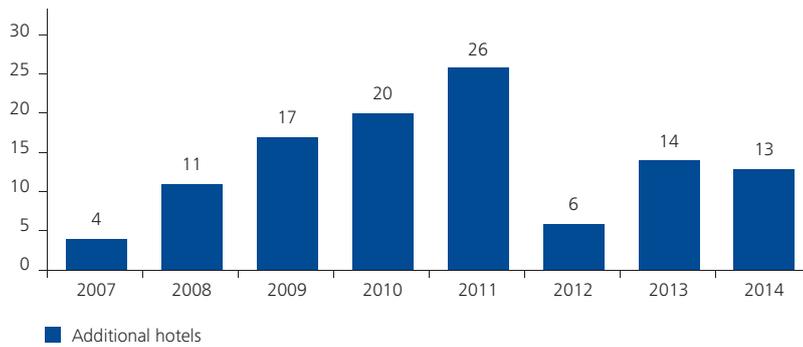
The demand side of the equation

Historical visitor growth in Dubai from 2003 to 2013 was 7.5 percent a year on average. In order for Dubai to achieve the 2020 target of 20 million visitors, the rate of growth required is almost 9 percent per year from 2014 until 2020. Over the last three years the growth in visitors has exceeded the 9 percent target and the growth in 2013 over the 2012 number was almost 10.5 percent following two previous periods of growth in excess of 9 percent, proving that these high levels of growth are indeed possible and may even be exceeded. The development of Dubai's tourism infrastructure and the ever-expanding route network of Emirates Airlines are helping to add to the number of visitors to Dubai. The average length of stay at Dubai hotels has also risen markedly from 2.2 days in 2002 to 3.2 days in 2013 whilst the length of stay at hotel apartments in Dubai has risen even more from 3.1 days in 2002 to 5.3 days in 2013, adding significantly to the demand for guest accommodation. So assuming there are no dramatic market shocks, we estimate that the demand side of the equation is not a major concern.

The history of room supply growth in Dubai

In the period between 2007 and 2011 a total of 78 new hotels were added in one of the busiest and most concentrated development periods in Dubai's recent history as shown in the chart below. At its peak the highest number of hotels delivered in a single calendar year was 26, in 2011. Much of the planning for these hotels would have begun at least four years prior to their delivery, given the typical hotel development cycle.

Hotels



The supply of hotel rooms grew at a compound average growth rate (CAGR) of 4.9 percent between 2007 and 2014.

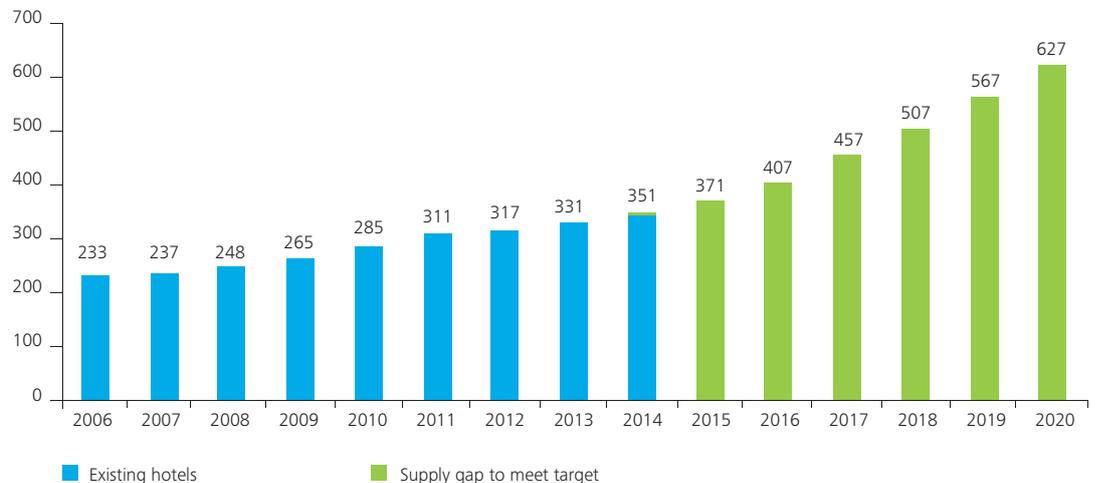
Hotel supply target for 2020

If we focus on hotels only, the market needs to deliver approximately 283 additional hotels between 2014 and 2020 in order to meet the doubling of hotel room stock (an additional 68,000 rooms) based on the average size of hotels recently developed in Dubai. According to data provided by STR Global, there are 56 hotels under construction or in the final stages of planning in Dubai across all hotel grades. This means that approximately 227 additional hotels are required to meet the supply target by 2020.

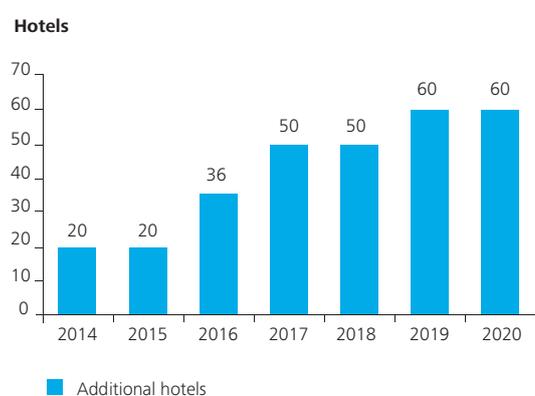
The delivery challenge

A typical hotel development cycle runs between 36 months and 48 months depending on the complexity of the project and the scale and standard of the hotel. This means that if hotels are to be delivered to the market prior to 2020, the majority of the planning needs to be completed prior to 2017 for delivery by 2020. We have compiled a simulation of how the supply of new hotels could be delivered in order to meet the requisite room supply target. At the end of 2013 there were 331 hotels in Dubai. The chart below indicates our simulated growth in supply taking into account the known/confirmed additional hotel supply (from STR Global data) and the required future supply growth taking into account the typical hotel development cycle.

Number of hotels in the pipeline



The previous simulation shows that in order to meet the supply of hotels by 2020, up to 60 hotels need to be delivered to market in at least two consecutive calendar years. (See chart below which shows our simulated roll-out of new hotels.)



Historically Dubai has managed to deliver an average of 14 hotels per year over the last 8 years up to a maximum of 26 hotels in a single calendar year. In order to meet the target of doubling the hotel room stock by 2020, this remarkable achievement needs to double to around 60 per year for at least three years, which is likely to be quite challenging.

Building the supply is not the only challenge

Not only is the physical delivery of the number of additional hotels in such a short timeframe going to be stretching the contractors' ability to meet the target but the impact of such high demand on construction materials, labor and, more importantly, funding is likely to drive overall development costs higher. Between 2014 and 2020 the GCC region will witness significantly higher levels of construction activity. Qatar is preparing for the FIFA 2022 World Cup, Dubai is gearing up for Expo 2020 and other general growth, and Saudi Arabia is forging ahead with numerous massive projects throughout the country. All of this demand is likely to impact overall construction costs, and consequently the attractiveness of hotel developments in Dubai, where year-to-date construction material costs have risen by around 5 percent between January and June 2014 alone. The mid-market sector, which is very margin-conscious, will likely be impacted the most by this higher development cost regime, thus reducing the investor appeal for this very necessary sector of the market.

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Location, location, location

In virtually any real estate investment, the mantra "location, location, location" holds true. As Dubai has matured into a complex and varied hospitality and tourism market, location plays an ever increasing role in the performance and value of real estate investments. With an additional 283 hotel sites needed between 2014 and 2020, the selection of suitable land plots for hotel development will become critical. The high demand for quality sites will drive land prices ever higher and in so doing, reduce investor returns. Mid-market hotels are again likely to feel the brunt of this hike in land pricing further reducing their appeal to prospective investors.

So what does this mean for the market?

Fortunately the profitability levels at most quality hotels in Dubai are such that there is capacity to absorb the escalation in development costs and still render healthy returns. For many years investors in Dubai's hotel sector have seen returns above other market norms. This "normalization" of the market will actually be a good thing for the market in the long-term. Market-wide occupancies are likely to be lower in the coming years and this will ultimately result in a lowering of room rates making the destination of Dubai more attractive to a wider audience and assist in achieving the targeted 20 million visitors in 2020 and even higher beyond that.

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