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STR GLOBAL

Quarterly Middle East Hotel Market Insight Report

Issue 2: Dubai, UAE

70% to 75%

OCCUPANCY

New normal Dubai market occupancy

126 33,350

126 hotels consisting of 33,350 rooms in planning or construction

217%

2015 Midscale Hotel Pipeline Growth

Since 2014

72% 42%

Occupancy before and after Ramadan

Ramadan Occupancy

In the Middle East since 1926

The tourism market in Dubai continues to be dominated by visitors from the Kingdom of Saudi Arabia ("KSA"), India and the United Kingdom ("UK")

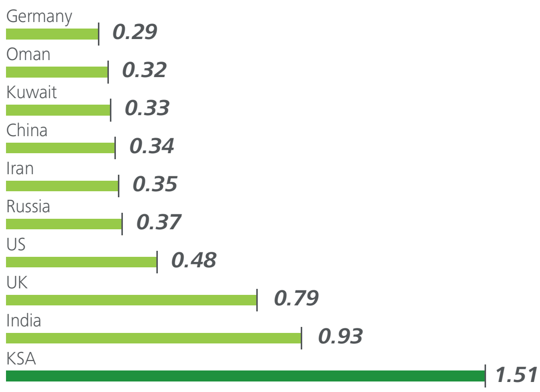
KSA drove the largest number of visits to Dubai in 2014 (1.5 million visits), followed by India (0.9 million visits) and the UK (0.8 million visits).

Visitation in 2014 from Dubai's top 3 source markets grew between 6% and 8% over 2013 visitation, but some of the smaller yet important source markets declined. Arrivals from the USA fell by just over 3% and almost 11% fewer Germans visited. Most notable was the 15% decline in visitors from Russia as a stalled economy and declining Ruble have led to much of the Russian source market seeking better value destinations. Visitation from China and Iran grew at 24% and 41% respectively indicating a growing appeal for Dubai from these source markets.

Dubai's hotel stock continues to rise

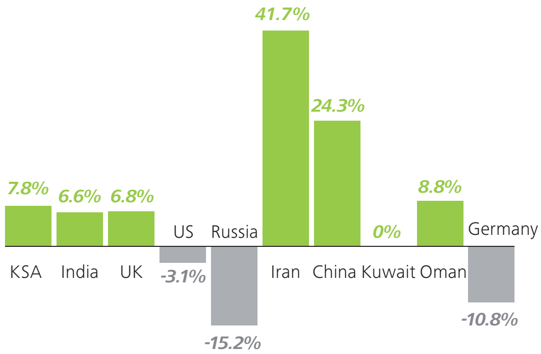
Dubai's hotel room supply, according to data provided by STR Global, was 369 hotels in July 2015 which reflects a compound average growth rate ("CAGR") of 5.25% from the 233 hotels in 2006. Over this period the number of rooms in Dubai rose from 39,000 (2006) across all sectors of the market to 75,600 in July 2015. Inventory growth over the 12 months to July 2015 was 7.5% with the highest sector growth in the Upper Upscale category (15%).

Figure 1 – Top ten hospitality source markets, Dubai, 2014



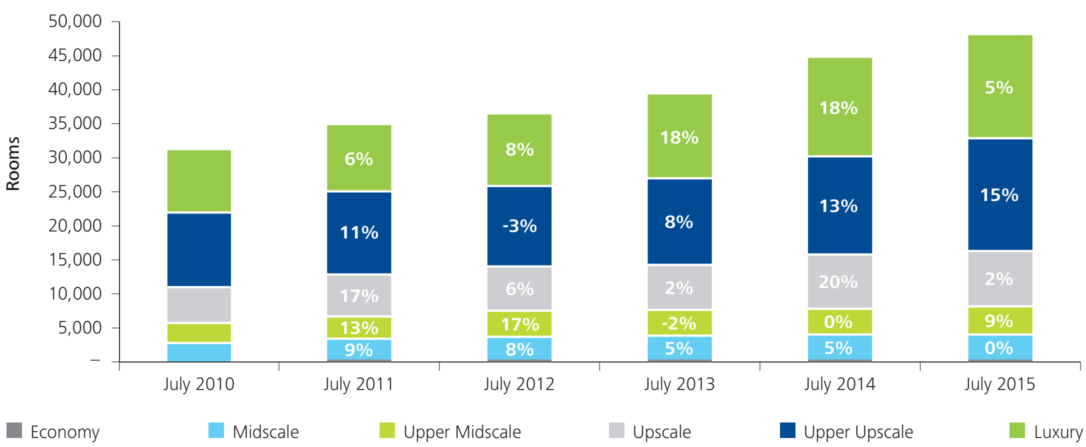
Source: Tourism Economics

Figure 2 – Percent change in hospitality source markets, Dubai, 2014 vs. 2013



Source: Tourism Economics

Figure 3 – Hotel inventory, Dubai, 2006 to Q2 2015



Source: STR Global

Dubai hotel occupancy, ADR and RevPar trends

Hotel performance in Dubai in the first half of 2015 was lower than the first half of 2014, with occupancy and ADR trending lower primarily driven by a slowing of demand growth and an increasing supply of hotel keys. A summary of the key market metrics in Figure 4 paints a picture of challenging conditions in terms of market performance. Notably, despite hotel demand growth being lower than in recent years it is still running at over 5% per year. It is primarily the rise in supply that has led to a softening in market occupancy and resultant ADR. Rates have generally been under pressure as global economic challenges continue in some of the key source markets and exchange rates further impact the perceived "value" of Dubai accommodation when compared to other destinations.

Demand for hotel accommodation in Dubai grew but at a slower pace than supply

Demand for hotel accommodation in Dubai has slowed in 2015 compared to 2014 with growth of 5.1% versus 6.4% in 2014 and 10.4% in 2013.

The rise in the supply of hotel accommodation in Dubai over the same period has outpaced demand growth with 6.7% growth in 2015, albeit this growth in supply is marginally lower than 2014 and 2013.

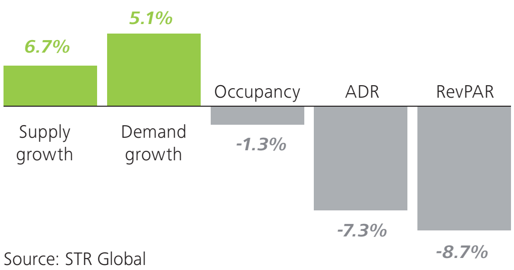
This mismatch in hotel supply and demand growth has resulted in occupancy declining by a relatively modest 1.3%, but more meaningful is the decline in ADR of 7.3%. This decline in ADR is reflective of the market defending occupancy through widespread rate discounting, to maintain market share.

The rising strength of the US Dollar and rising Dubai wide ADRs have over recent years eroded the value proposition of Dubai, which is now seen as a more expensive destination than it has in the past.

Observation: In order to ensure relevant analysis of performance, we have compared data for the period January to May 2014 vs. 2015 to highlight changes in market performance. The period of January to May has been selected to isolate the marked effects of Ramadan on hotel market performance which when included distorts the period by period comparison. All references to 2014 and 2015 thus refer to the period January to May unless otherwise specified.

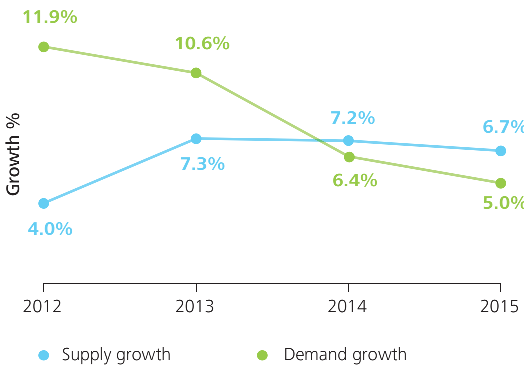
Note: We have analysed the impact of Ramadan on Dubai's hotel market separately in this report

Figure 4 – Hotel performance percent changes, Dubai Jan-May 2014 vs. 2015



Source: STR Global

Figure 5 – Supply growth vs. demand growth, Dubai, 2012 to 2015



Source: STR Global

Opinion: Deloitte does not consider the rise in supply and the resultant lowering of occupancy and ADR as a negative situation for Dubai. Competitive room rates are necessary to drive tourism volume growth which is clearly the long term focus for Dubai.

Continued pipeline growth reflects confidence

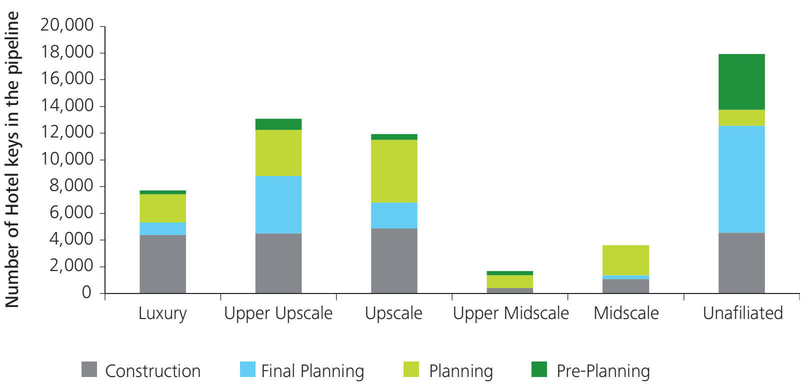
The Dubai hotel investment and development market reacts strongly to supply and demand fundamentals and the continued aggressive hotel pipeline is symptomatic of a market that is positive about the future.

In July 2014 there were 71 known hotels across all market sectors in varying stages of planning or construction in Dubai (22,000 rooms). As of September 2015 there were 126 hotels in the pipeline (33,350 rooms) indicating a rise of some 51% in the number of rooms in the known pipeline.

The highest growth in room supply is anticipated in the Luxury sector with just over 6,400 new rooms and the Upper Upscale sector is projected to rise by just over 6,000 rooms.

The Dubai Tourism and Commerce Marketing ("DTCM") incentives for the development of mid-market hotels appears to be achieving its aims as the 2015 mid-scale and upper mid-scale sectors show a pipeline growth of 217% against the known pipeline in 2014.

Figure 6 – Hotel pipeline by construction status, Dubai, 2015 to 2019



Source: STR Global

The continued growth in demand, fueled by ongoing improvements in tourism infrastructure and strong hotel operating performance, has stimulated continued investor interest in hotel development in Dubai.

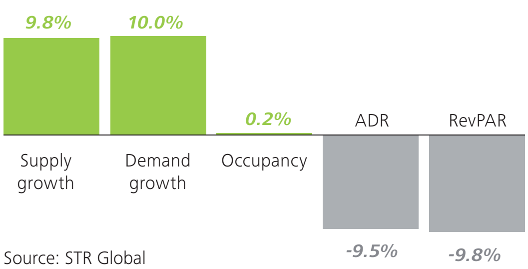
The Luxury sector

When the impact of Ramadan is removed from an analysis of performance, the occupancy for the period year to date ("YTD") end May 2015 is marginally higher than the same period in 2014, despite a rise in room supply of almost 10% (1,641 keys). This augers well for the Luxury sector demonstrating its resilience with actual room night demand growth of 10% when comparing the first 5 months of 2015 vs. 2014.

A decline in average daily rate ("ADR") of 9.5% for the first 5 months of 2015 over the same period of 2014 is indicative of a wider strategy to maintain occupancy in the Luxury sector in Dubai. ADR for this period has risen only moderately since 2011 with a CAGR of 4.3% per year, so the decline of more than double this rate is illustrative of perhaps a market sector that recognises that room rates at these high levels is not sustainable to continue growing the demand base.

Luxury sector revenue per available room ("RevPAR") has declined by almost 10% for the first 5 months of 2015. Average RevPAR for the period to May 2015 is now lower than it was in the same period in 2012 but is nevertheless still 11% up from 2011 RevPAR levels. It is evident that the growth in supply has resulted in the market discounting rates to ensure occupancy targets are achieved. At these relatively high RevPAR levels the market has been able to discount minimally to ensure demand remains relatively consistent. Should the supply and demand growth mismatch continue we could see both ADR rates and occupancy decline in tandem.

Figure 7 – Luxury sector, Key Performance Metrics comparison, Dubai, 2015 vs. 2014



Source: STR Global

The Upper Upscale sector

Dubai's Upper Upscale sector has shown a more noticeable decline in occupancy with a -1.7 percentage point drop for the year to May 2015 vs. the same period in 2014, following a 1.9% drop from the same period in 2013. Room night demand grew by 9.6% from January to May between 2014 and 2015 showing solid performance but room supply grew at almost 12% thus resulting in a decline in occupancy.

Upper Upscale ADR in Dubai declined by 9.5% in the 5 months to May 2015 showing a defensive rate strategy to maintain occupancy in the face of rising inventory growth across all sectors and the resultant increase in competition. ADR has grown at a CAGR of almost 8% since 2011 along with demand rising at similar levels.

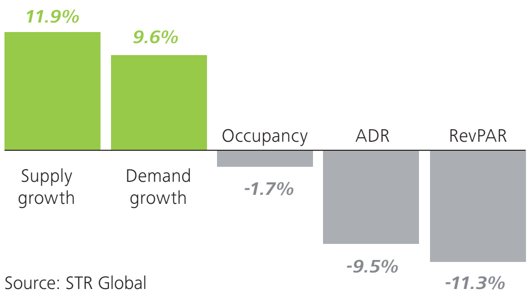
RevPAR in Dubai's Upper Upscale sector declined by 11.3% in the first 5 months of 2015. Whilst this decline appears dramatic, when seen in the context of a 39% rise in inventory since 2011 (and almost 12% in 2015 alone), at an average RevPAR growth since 2011 of 14%, the decline is not surprising.

The Upscale sector

A decline in occupancy of 2 percentage points for the year to May 2015 vs. the same period in 2014 for Dubai's Upscale class was primarily due to a mismatch in demand growth of only 2% vs. room supply growth of 4.4%. Occupancy for the first 5 months was nevertheless still very strong at almost 85%.

The ADR in Dubai's Upscale sector declined at a lower rate than the market as a whole (7.3%) primarily because supply growth in this sector was relatively modest at only 4.4%. Upscale ADR for the first 5 months of 2015 was 6.6% below the ADR for the same period in 2014. Average (CAGR) ADR growth for the 3 years since 2011 was almost 9% so the drop in rates is at this time not alarming.

Figure 8 – Upper Upscale sector, Key Performance Metrics comparison, Dubai, 2015 vs. 2014

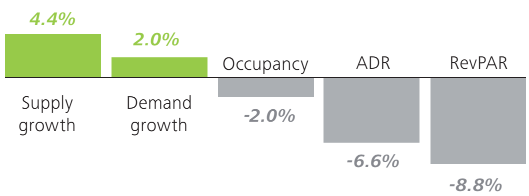


Source: STR Global

The Dubai hotel investment and development market reacts strongly to supply and demand fundamentals and the continued aggressive hotel pipeline is symptomatic of a market that is positive about the future

The decline in Dubai's Upscale RevPAR is more notable with a drop of almost 9% against a growth in inventory of just 4.4%. Discounting in this sector appears to be more aggressive to maintain competitiveness with a narrowing rate gap between some of the Upper Upscale properties. RevPAR growth in the 3 prior years (2011 to 2014) was almost 50% and so the correction is indicative of the slowing demand in this sector and the reaction of the market to maintain occupancy.

Figure 9 – Upscale sector, Key Performance Metrics comparison, Dubai, 2015 vs. 2014



Source: STR Global

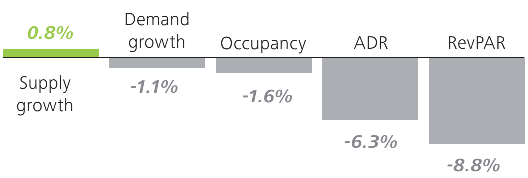
The Upper Midscale & Midscale sector

In absolute terms, Dubai's Upper Midscale and Midscale sector continues to produce very strong occupancy levels at almost 88% for the year to May 2015. The sector has however seen a 1.6 percentage point decline in occupancy over the same period of 2014. This decline is reflective of the actual decline in demand of just over 1% coupled with marginal growth in supply of just less than 1%.

ADR in Dubai's Midscale sector is down by 6.3% for the period January to May 2015 vs. the same period in 2014, reflecting a slowing of demand growth over the past 3 years and an actual decline in demand for the first 5 months of 2015.

Dubai's Upper Midscale and Midscale sector has seen a 7.3% decline in RevPAR in the first 5 months of 2015 driven by a moderate decline in both occupancy and ADR. This decline follows a marginal decline of 3.5 percentage points in 2014 over the same period in 2015.

Figure 10 – Upper Midscale & Midscale sector, Key Performance Metrics comparison, Dubai, 2015 vs. 2014



Source: STR Global

Ramadan – a different market dynamic?

The Holy month of Ramadan is one of the five pillars of Islam and is a time for reflection and family for Muslims around the world. During Ramadan the majority of Muslims restrict their travel and as such this has a very noticeable impact on hotel performance in Dubai.

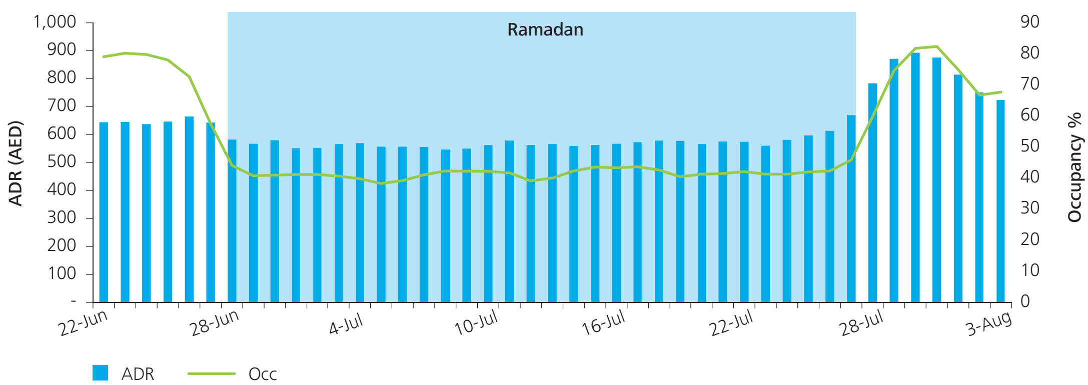
The timing of Ramadan moves forward each year by approximately 10 days in the Gregorian calender and as such the impact of Ramadan varies when comparing one calendar month versus the same calendar month in successive years. Ramadan typically crosses over two months and as a result any analysis of hotel performance needs to be cognizant of this fact. As such we have isolated Ramadan from our analysis when comparing hotel performance on a period by period basis.

Occupancy during the 4 weeks of Ramadan in Dubai in 2014 was substantially lower at 42% compared with 74% for the shoulder periods (1 week) immediately before and then after Ramadan. ADR during Ramadan 2014 was 20% lower (AED588) than for the shoulder periods (AED734).

The pattern of substantially lower occupancy and ADR was repeated in 2015 with occupancy during Ramadan almost identical but ADR in 2015 was 7.5% lower, similar to the ADR decline across the market.

The combination of lower demand during summer from non-GCC markets and the lack of Muslim travel has a double impact during the summer months in Dubai.

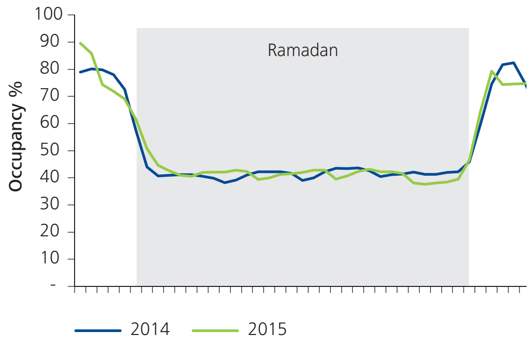
Figure 11 – Ramadan ADR & Occupancy, Dubai, 2014



Source: STR Global, Deloitte

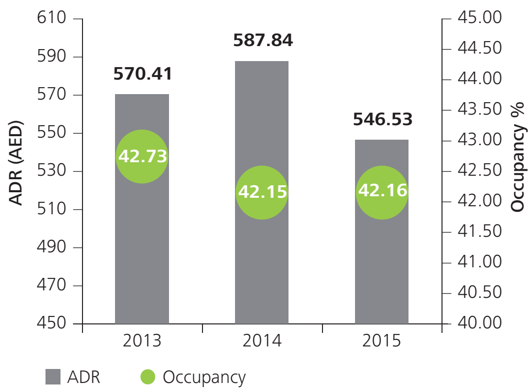
The trend over the past 3 years indicates marginal variance in occupancy but significant fluctuations in ADR ranging between 3% and 8%. ADR during the relatively short Ramadan period varies depending on the number of weekends in Ramadan due to evidence of lower rates over weekends.

Figure 12 – Ramadan Occupancy, Dubai, 2014 vs. 2015



Source: STR Global, Deloitte

Figure 13 – Ramadan performance trends, Dubai, 2013 to 2015



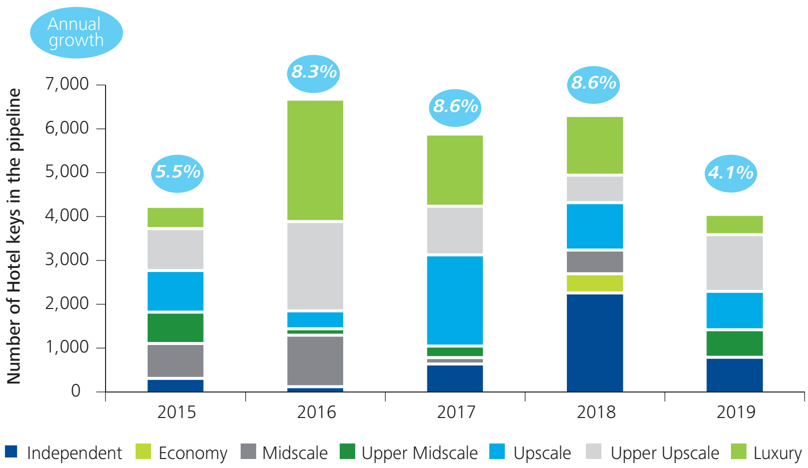
Source: STR Global

During Ramadan the majority of Muslims restrict their travel and as such this has a very noticeable impact on hotel performance in Dubai

Is it time for a "New Normal" in Dubai's Hotel market?

The DTCM target of reaching 20 million tourist visits by 2020 is an ambitious goal which will require growth in tourism arrivals of approximately 9.5% per annum to achieve the target. One of the key challenges the market faces in reaching these growth targets is the provision of hotel rooms at room rates that make Dubai attractive as a destination to a wider range of market segments. Dubai's hotel inventory is dominated by Luxury and Upper Upscale hotels with rates that are amongst the highest in the world. There is strong growth in the more affordable mid-scale sectors but further growth is needed to generate the tourism demand to meet the DTCM targets.

Figure 14 – Hotel Development Pipeline, Dubai, as at Q1 2014

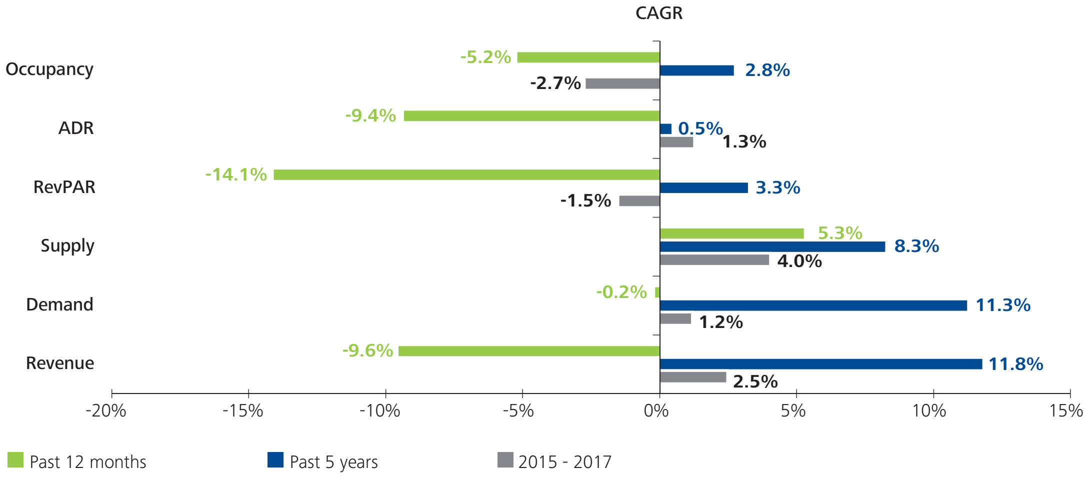


Source: STR Global, Deloitte

The market performance over the last few years has demonstrated that the rising inventory has put pressure not only on occupancy but also importantly on room rates

As the market performance over the last few years has demonstrated, the rising inventory has put pressure not only on occupancy but also importantly on room rates. Figure 14 shows that the growth in room supply is set to continue at 6.3% CAGR over the next 4 years. Growth forecasts by STR Global and Tourism Economics indicate estimated demand growth up to 2017 of 1.2% (Figure 15) as the source markets deal with numerous global and regional economic, socio-economic and political challenges. As we have already seen, ADR and occupancy typically decline in markets where supply growth outstrips demand growth. This declining trend is set to continue but unlikely to be at levels that make the hotels unprofitable. The era of 80% occupancy and world leading ADR's generating super profits at Dubai's hotels could be nearing an end. It is anticipated that given the market fundamentals strong occupancy levels at around 70%-75% are likely to represent the "new normal" going forward a growing availability of high quality mid-market hotels increase pressure on room rates. Rather than being a negative, this can potentially be viewed as a positive as this will help Dubai become more affordable as a destination and support the growth in tourism volume required to activate the investment in tourism infrastructure being developed over the coming years.

Figure 15 – Hotel Market Performance Summary, Dubai, 2014 - 2017



Source: STR Global, Tourism Economics

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- Development appraisals
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