The Dubai Hotel Market – Hot or Soon to Overheat…?

By Sarah Leemann and Elie Younes – HVS International

… How much further will it grow? Is it really a supply-led market? Can a market correction be expected soon? What is a reasonable marketwide stabilised performance? All these questions have undoubtedly been discussed amongst industry professionals who have visited Dubai or have worked in the market over the last five years. Here is the story and probably some answers!

Dubai, December 2004: again one of the top outperforming markets in the Middle East, according to HVS International's annual survey. With RevPAR (rooms revenue per available room) of US$124 and GOPPAR (gross operating profit per available room)[1] of US$110, Dubai ranked second behind Kuwait (which was still enjoying a high ADR and extraordinary demand due to the outbreak of and the ongoing war in Iraq).

Dubai, October 2005: a limited amount of new hotel supply has entered the market since the beginning of the year, and the market continues to see excellent operating performances in terms of both occupancy and average room rate. Dubai has taken the lead in the region for the first three quarters of the year! We expect the market to experience accelerated growth (of more than 30%) in GOPPAR in 2005; this growth will be driven mainly by the considerable increase in average room rate.

Given the historical and anticipated future supply and demand dynamics, there is currently no consensus on the future performance of the market; opinions are hybrid and often controversial.

In this article, we illustrate the historical and current success story of Dubai, discuss and assess the market dynamics, and provide an opinion of the potential future performance of the market. The following topics are addressed.

- Overview of the UAE and Dubai;
- Dubai tourism and initiatives;
- Hotel market dynamics;
- Assessment of future trends;
- Synthesis and conclusion.

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[1] See also article by Elie Younes and Russell Kett entitled "GOPPAR a Derivative of RevPAR", published in February 2003

Overview of the UAE and Dubai

Below are some of the macro economic highlights.

General Overview

- The United Arab Emirates (UAE) consists of seven emirates: Abu Dhabi, Ajman, Dubai, Fujairah, Ras al-Khaimah, Sharjah and Umm al-Qaiwain. The capital and also the richest emirate is Abu Dhabi; yet, some consider it to be Dubai. In general, the emirates have remarkably few tourist attractions;
- Despite the government's substantial efforts to diversify the economy, oil revenues remain the major economic driver of GDP in the UAE, accounting for roughly a third;
- Some emirates are pursuing a policy of openness with greater zeal than others, with Dubai remaining at the forefront of most new initiatives. In particular, Dubai is expected to continue to seek investors in high technology, financial services, tourism and other service industries to compensate for the declining role of oil in its economy.

Table 1 Key Economic Indicators – UAE

	Actual								Forecast	
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Real GDP growth (%)	8.1	1.1	3.7	6.9	2.9	1.8	7.0	5.9	5.8	5.5
Consumer price inflation (av %)	2.0	2.0	2.1	1.8	2.0	2.9	3.1	3.6	3.3	3.0
Exchange rate AED:US$ (av)	3.67	3.67	3.67	3.67	3.67	3.67	3.7	3.7	3.7	3.7

Sources: Economist Intelligence Unit, February 2005; Department of Economic Development

- In 2004 approximately 10% of the economic wealth was contributed by travel and tourism. This share is expected to rise to 10.5% in 2005;
- According to the Economist Intelligence Unit (EIU), the country's economy experienced strong growth of 5.9% in 2004. This growth was driven mainly by an increase in oil output, combined with firm prices. The country's economy is expected to continue to experience strong growth in 2005 and 2006, with growth driven mainly by strong oil prices.

Dubai – An Overview of the City

- Dubai, with an area of 3,885 km², is the second-largest emirate in the UAE. It is located in the north-eastern part of the UAE and is currently considered to be the only emirate that would remain prosperous without oil and gas revenues;
- Currently, according to the Dubai Ministry of Planning, 910,000 people (of whom almost 80% are expatriates) live in Dubai, and they account for approximately 27% of the UAE's population;

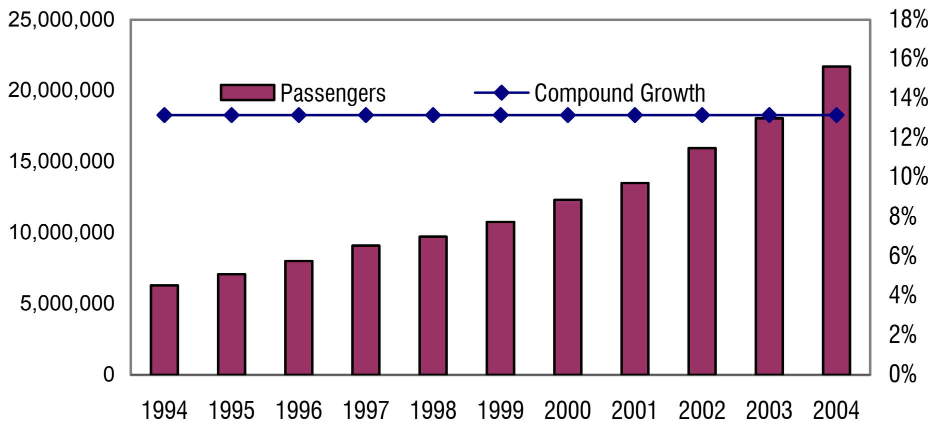
- Dubai has a very good infrastructure, with Dubai International Airport being one of the busiest airports in the region, especially in terms of transit passengers. Yet, given the recent growth in the level of visitation and the level of population, improvements to the road network within the city will soon be required (infrastructural plans and developments already exist, however, and are underway);
- Over the last decade, the ruling Maktoum family has positioned Dubai as a major tourism and economic hub. Extensive public initiatives have been undertaken to stimulate economic growth and direct foreign investments.

Dubai Tourism and Initiatives

Visitation – Snapshot

Table 2 illustrates the total number of visitor arrivals in Dubai since 1994.

Table 2 Domestic and International Airport Passengers – Dubai, UAE



Source: Dubai Department of Tourism and Commerce Marketing

- Over the last 11 years, the total number of passengers at Dubai International Airport has grown at a compound annual rate of around 13%. Despite the war in Iraq and recent political unrest in the Middle East, the total number of airport passengers arriving in Dubai increased by some 13% in 2003 and 20% in 2004, reflecting the strong competitiveness of the emirate in the economic and leisure sectors;
- This upward trend was further stimulated by the increased efforts made by the government to promote the emirate as a politically stable destination with a booming economy and attractive leisure facilities. In addition, Dubai has benefited from increased intra-regional travel following the events of 11 September 2001 and the war in Iraq;

- Emirates is one of the most prominent airlines at Dubai International Airport. The company has recently opened new routes to, for example, the USA, Australia, the UK and China. In the last 18 months, the airline has placed orders for 41 aircraft from Airbus and 26 from Boeing. These will come into operation progressively over the next four years, and this will undoubtedly have a considerable and positive impact on the level of visitation to Dubai.

Initiatives and Developments

Some say that one-third of all construction cranes worldwide are currently in Dubai. Given the current level of development in the market, such a statement is possibly not an exaggeration. Table 3 illustrates some of the major developments currently taking place in Dubai.

Table 3 New Projects – Dubai, UAE 2005-15

Project Name	Estimated Cost of the Project (US$ billion)	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Dubai Maritime City	N/A		✓									
Dubai International Financial Centre	1.0		✓	✓								
Dubai Festival City	1.5			✓								
Dubai Pearl Development	0.3		✓									
Green Community Village	0.2											
International City	N/A	✓										
Dubai Marina	N/A	✓										
Palm Project: Jebel Ali, Jumeirah & Deira	12.2					✓	✓					
Mall of the Emirates	N/A			✓								
Dubai Mall	N/A			✓								
The World	1.8				✓							
Dubailand	N/A											✓
Dubai Health Care City (DHCC)	5.0					✓						
Cargo Village Expansion	0.3						✓					
Old Dubai	N/A											
Metrol Line Network	3.9					✓						
Ras Al Khor Bridge	0.5				✓							
Dubai Waterfront	N/A											
Airport Expansion	0.25			✓								

Source: HVS Research

As can be seen from Table 3, there is currently an extensive amount of new, large-scale development in Dubai that is being developed by both the public sector and the private sector at an estimated total cost of around US$30 billion. Such projects relate to both leisure and business, which is something of a reflection on the well-balanced economic development plan for the emirate. In addition, infrastructural projects are also planned in Dubai, which will in all likelihood support any growth in visitation.

Over the last decade, Dubai has pioneered major initiatives in the GCC region in an attempt to stimulate economic growth and foreign direct investment. Such initiatives and/or catalysts include the following.

- *Freehold ownership for foreigners*

  In May 2002 the Crown Prince of Dubai and the UAE's Defence Minister announced that 100% freehold ownership of certain properties in Dubai was available to all nationalities on specific large-scale developments (such as the Palm Islands, Dubai Land, etc) and in certain areas of the emirate.

- *Free-Trade Zones*

  The government has sought to encourage global firms to move their regional offices to Dubai by establishing free-trade zones, such as the Jebel Ali Free Zone (JAFZ) and, more recently, Dubai Internet City, Dubai Media City, Dubai Knowledge Village and Dubai International Financial Centre. Companies operating in a free-trade zone benefit from zero duty on all imported and exported goods and machinery within the zone, 100% foreign ownership (no need for a local sponsor), a renewable 50-year guarantee of exemption from corporate tax, no personal income tax and no restrictions on the repatriation of capital and profits.

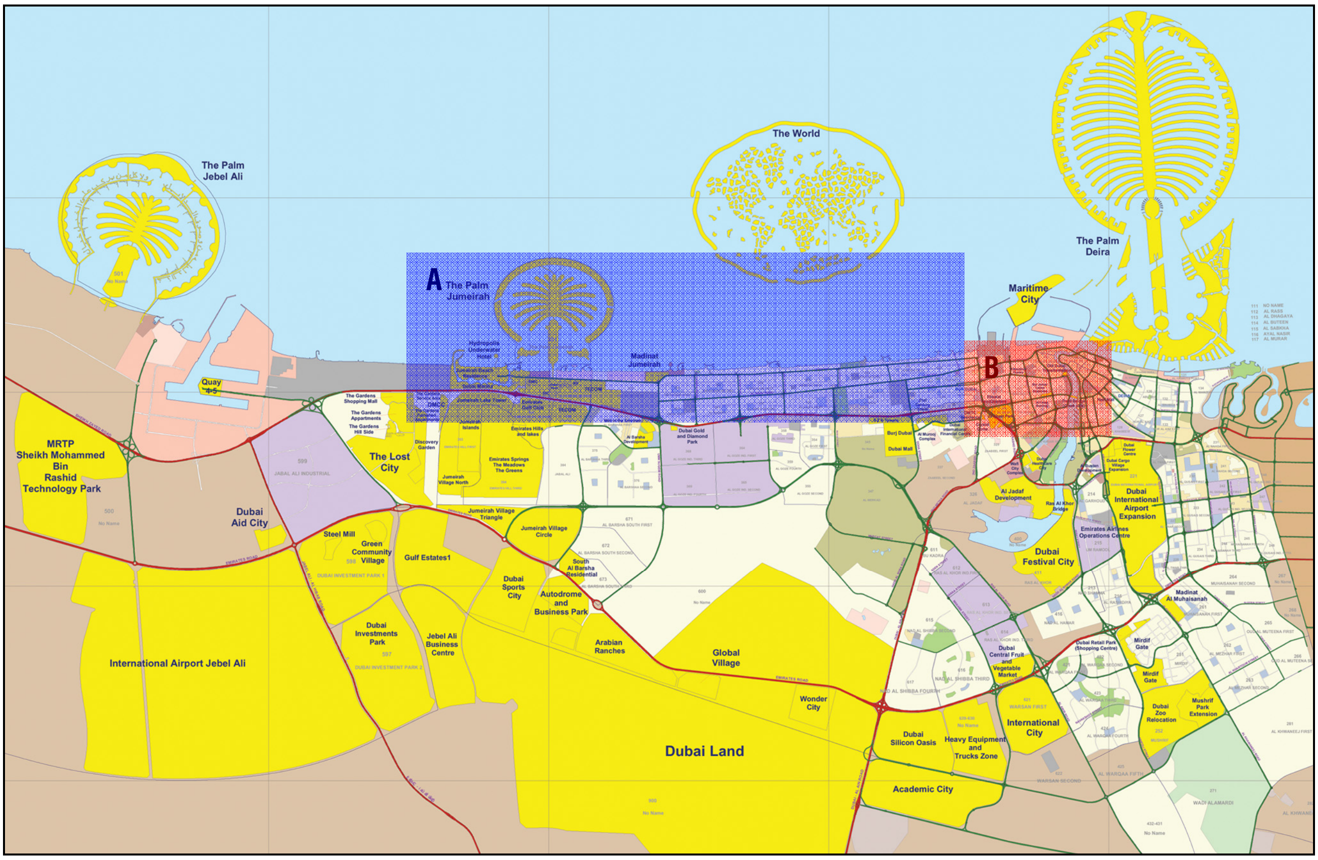
- *Obtainability of Visas*

  All visitors, except GCC nationals, require a visa; however, free visit visas are issued to most nationals entering Dubai. A visit visa is valid for up to 60 days, but can be renewed for a further 30 days upon paying a fee of AED500 at the Department of Immigration. Currently, nationals from more than 30 countries do not require anymore a visa to enter the emirate/country.

Hotel Market Dynamics

Snapshot and Characteristics

The Dubai hotel market is divided into two major sub-markets: Jumeirah Beach and the City, as shown in the following map. Although both markets are impacted by the same macro-economic factors, they have different characteristics and dynamics.



Area A: Jumeirah Beach Hotels   Area B: City Hotels

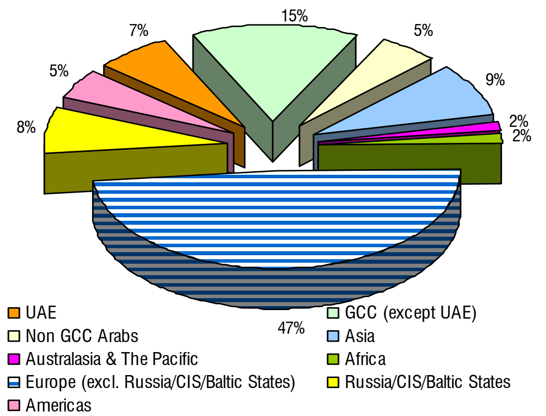
Table 4 illustrates the main characteristics of the hotel market in Dubai. We make the following comments on Table 4.

- Europe is the main feeder market for five-star hotel demand in Dubai, accounting as it does for around 47% of the total demand. The GCC and non-GCC Arab countries account for some 27% of the total demand for hotel accommodation. The market experienced increased levels of intra-regional tourism following the events of 11 September 2001 and the war in Iraq in 2003;
- Published plans exist to attract the Turkish, Pakistani, Indian, Chinese and Iranian markets over the next three to five years;
- The government is currently working on developing the cruise market to Dubai, which is also expected to have a positive impact on international demand for hotel accommodation in the area;
- In general, the seasonality of demand is becoming less volatile, thanks mainly to increased corporate (and meeting and conference) demand throughout the year. The peak in demand occurs in winter and spring; this is attributable to the rise in the number of arrivals from European nations, as the warm climate is favourable for beach holidays, as well as increased corporate and meeting and conference visitation.

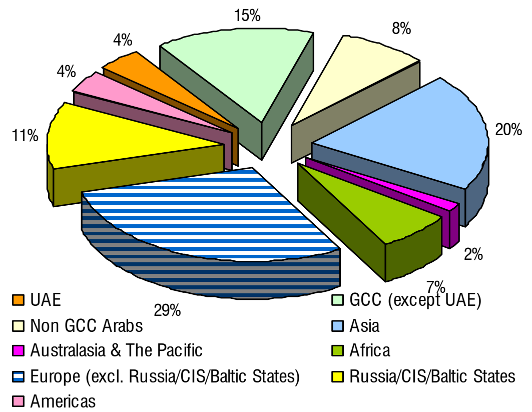
Table 4 General Characteristics – Hotel Market, Dubai

SOURCE MARKETS

Five-Star Hotel Market

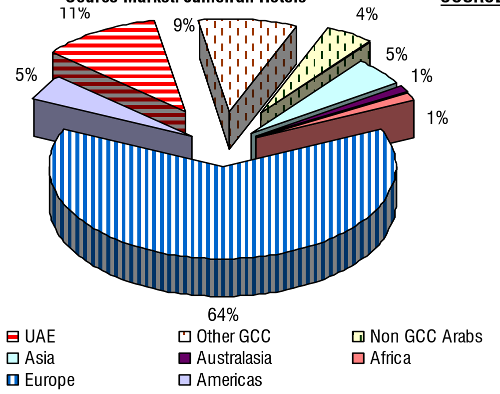


Source Markets for all Hotels

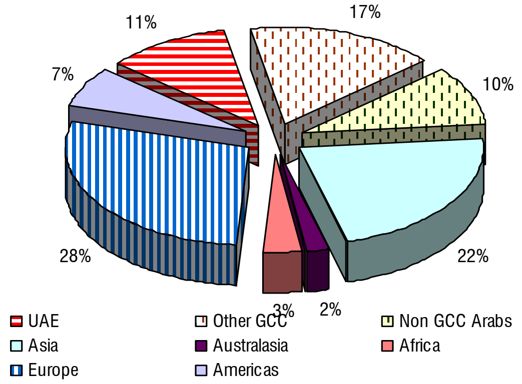


SOURCE MARKETS

Source Market: Jumeirah Hotels

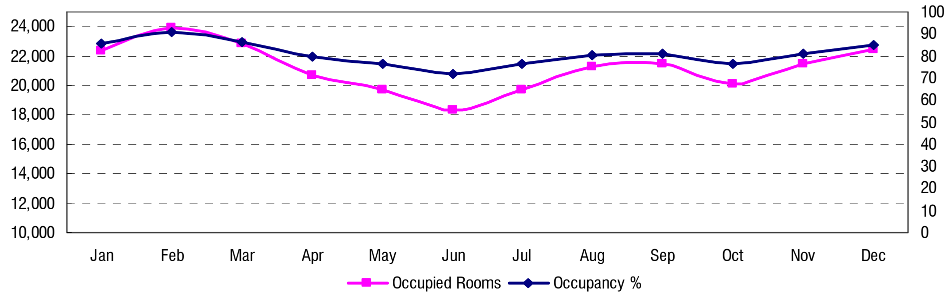


Source Market: City Centre Hotels

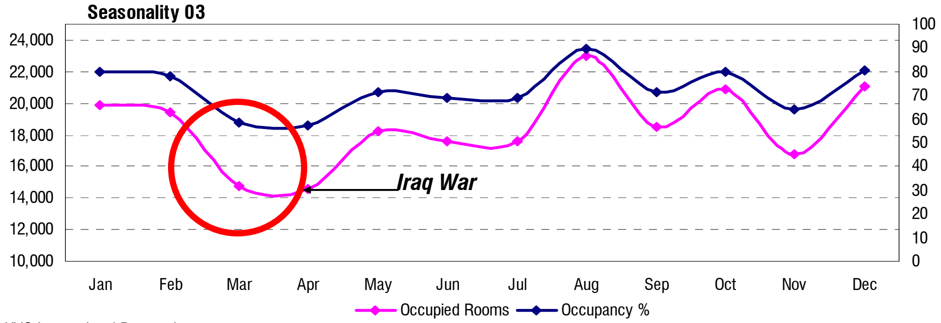


SEASONALITY

Seasonality 04



Seasonality 03



Sources: HVS International Research

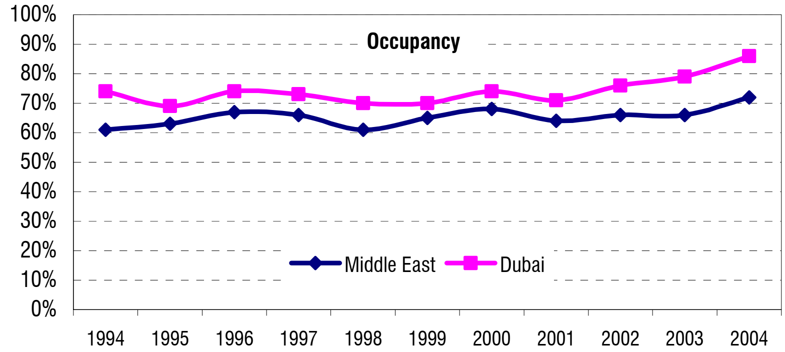
- The main source markets for the Jumeirah Beach hotels are European, which account for 64% of the total demand. Interestingly, this feeder market accounts for only 28% of the total demand in the City hotel market. This difference is down mainly to the stimuli for the European markets, which are different from those of the regional and GCC markets;
- The Arab world accounts for 38% of the total demand for City hotels and is the main source market for the downtown hotels.

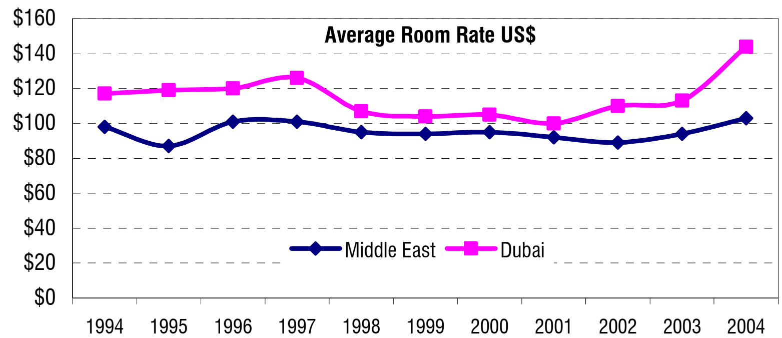
Hotel Market Performance and Dynamics

Table 5 illustrates the historical operating performance of the hotel market in Dubai. We make the following comments on Table 5.

- Over the last ten years the Dubai hotel market has outperformed the Middle East as a whole in terms of occupancy, average room rate and, hence, RevPAR. Over the last ten years, the market has achieved an average occupancy of approximately 74%, which is the highest in the region;
- The market achieved a ten-year record performance in 2004, with occupancy of approximately 86% and an average rate of US$145, resulting in RevPAR of US$124. Given the strong RevPAR performance of the market and its revenue mix characteristics (strong demand for food and beverage facilities), GOPPAR was US$110, an almost 90% conversion of RevPAR;
- In general, the market is likely to experience a slight decrease (or stable performance) in occupancy in 2005 when compared to 2004; however, strong ADR growth is anticipated this year (driven by firm pricing strategies adopted by hoteliers in the market). The steady market wide occupancy forecast for 2005 is mainly due to the new supply that entered the market throughout the year (Park Hyatt, Mina Al Salam, Al Qasr, etc). However, we would stress that the total number of room nights in the market will experience a growth when compared to 2004 levels.

Table 5 **Dubai's Historical Market Performances vs Middle East Market Performance (US$)**





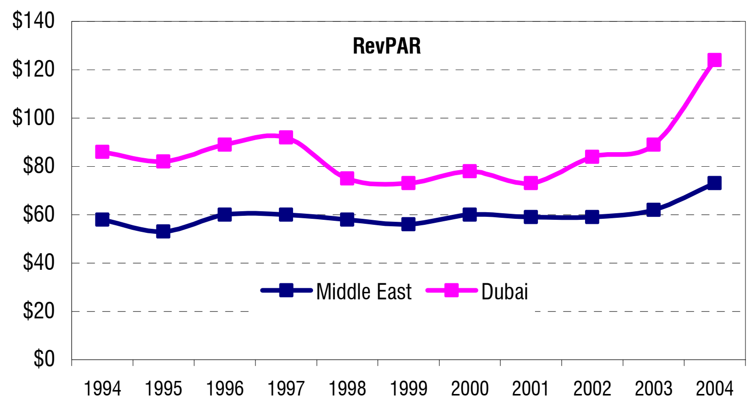
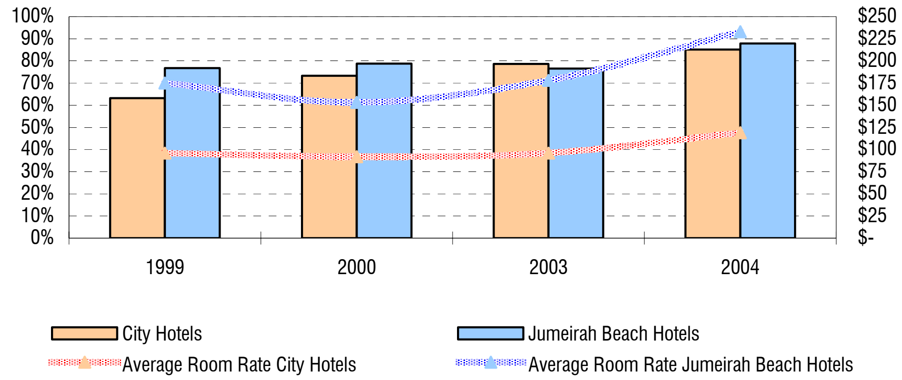


Table 6 illustrates the historical occupancy and average room rate performance of the Jumeirah Beach and City hotels.

- The Jumeirah Beach hotels have outperformed the City hotels in terms of occupancy over the last five years, on average by a couple of percentage points;
- Over the last five years the average room rate achieved by the Jumeirah Beach hotels was significantly higher than that achieved by

the City hotels; this was driven mainly by the location of such properties – on the beach – and by their market/product positioning.

Table 6 Historical Occupancy Performance and Average Room Rate –City Hotels vs Jumeirah Beach Hotels 1999-04



Source: HVS International Research

Other Asset Classes

We make the following comments on the market characteristics of other hotel derivatives (or relevant real estate markets) in Dubai.

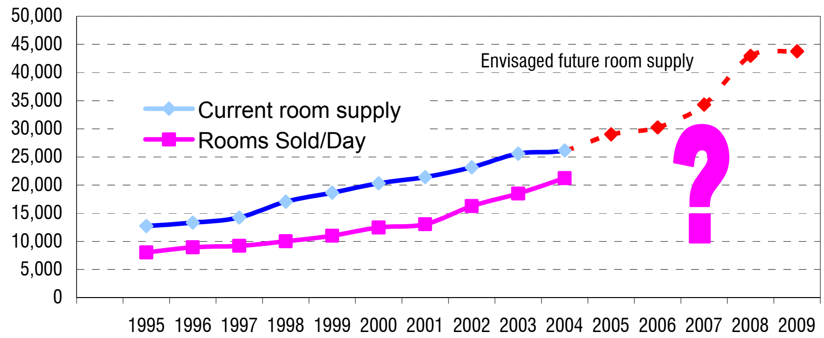
- Given the economic boom in the emirate, and the increasing number of expatriates visiting (or dwelling in) the city, demand for serviced apartments has been extremely strong. This was reflected in the strong operating performance of this sector of the market over the last three to five years (occupancy of approximately 87% and an average room rate of approximately US$95);
- The residential and commercial property markets continue to experience strong demand, and this has had a further positive impact on the demand for hotel derivatives. Such derivatives include serviced apartments, time share resorts, fractional ownership properties, and condo hotels. We would stress that while there is a trivial relationship amongst the general real estate markets and the various hotel derivatives in mature markets, in emerging markets such as Dubai, we consider the real estate market, together with the characteristics of transient demand, are important barometers that might signal, or otherwise, the potential demand (and development opportunities) for various hotel derivatives.

Assessment of Future Trends

Assessment of the Threat of the New Supply, and Historical Dynamics

From our research, we expect between 18,000 and 20,000 hotel rooms to enter the market by 2010, an increase of almost 100% on the current rooms supply. This will undoubtedly fuel the risk of an oversupply emerging marketwide in Dubai!

Table 7 Dubai's Forecast New Supply 2005-09



CAGR Supply – 1994-04	7%
CAGR Demand – 1994-04	10%

Sources: Dubai Tourism Authorities; HVS International Research

Over the last decade, hotel supply and demand in Dubai has grown at a compound average rate of approximately 7% and 10%, respectively, which clearly reflects the ability of the market to absorb any new level of supply, as shown in Table 7. This *could* imply that demand growth is likely to catch up with supply growth over the next few years. In addition, we note that Dubai has a stronger economic base than most other hotel market destinations in the Middle East, and the emirate benefits from having possibly the best tourism infrastructure in the region. This might, in turn, reduce the negative impact of the new supply.

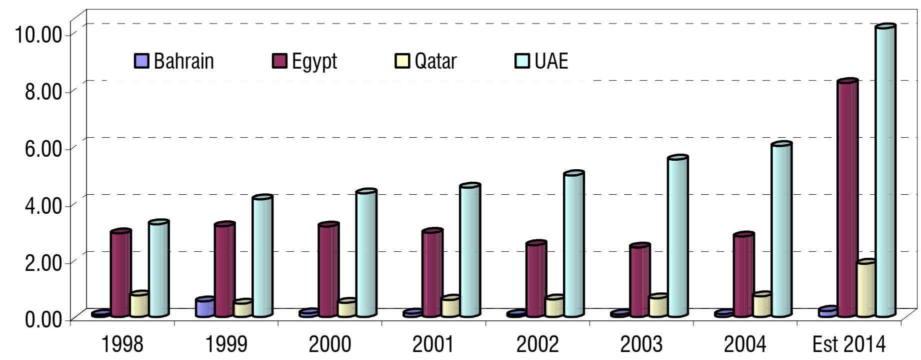
In keeping with other emerging markets, the public sector drives a large proportion of the growth in the tourism industry. We have conducted a comparative assessment of tourism-related public spending that compares the UAE to selected destinations in the region. We would highlight that, while such benchmarks reflect the country (or countries) as a whole, in the case of the UAE we consider such investments to predominantly reflect Dubai as most public initiatives have, so far, been geared towards the tourism development of this emirate and, to a lesser extent, Abu Dhabi.

Table 8 illustrates a tourism spending index in regards to **Government Expenditure** and **Capital Investment** in the UAE as it relates to other destinations in the Middle East. These benchmarks were obtained from the WTTC country reports and assessed by HVS International. We note the following definitions of such benchmarks.

Government Expenditure (Collective) ('GS'): also known as Non-Market Services (Collective), this category includes operating expenditure made by government agencies on services associated with Travel & Tourism, but not directly linked to any individual visitor; instead, these expenditure are generally made on behalf of the 'community at large', such as tourism promotion, aviation administration, security services, resort area sanitation services, and so forth.

Capital Investment ('GI'): also known as Capital Formation, this category includes capital expenditure by direct Travel & Tourism industry service providers and government agencies to provide facilities, equipment and infrastructure to visitors.

Table 8 Total Government Spending – GS and GI (US$)



Source: WTTC Reports

Based on an illustrative sample of four countries in the Middle East (Bahrain, Egypt, Qatar and the UAE), Table 8 clearly shows that the UAE (notably Dubai) is the regional leader in terms of public expenditure on the tourism sector. This reflects both the government's commitment to growing the industry, as well as a 'supply-led' hotel market.

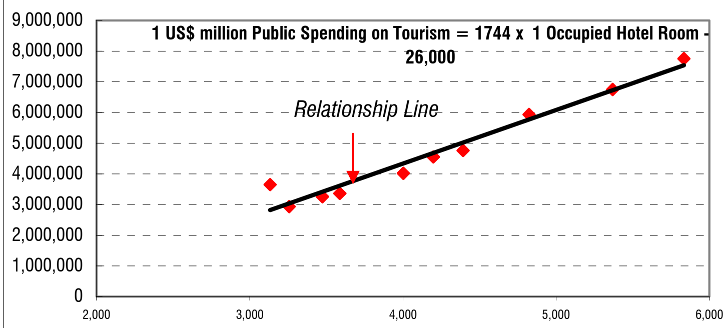
By 2014, according to the WTTC, it is expected that Dubai will double its current 'tourism-related' public expenditure.

We (and many professionals in the industry) have historically considered the hotel market in Dubai to be a 'supply-led demand' market. This signifies that the demand for hotel accommodation has historically been driven mostly by the new supply and government spending associated with it (be it on marketing, hotel/tourism investments, or infrastructure such as the airport and airlines). Therefore, we have conducted a relationship analysis between the total number of rooms occupied in Dubai and the total amount of public capital investment in the industry.

Table 9 illustrates our assessment and findings.

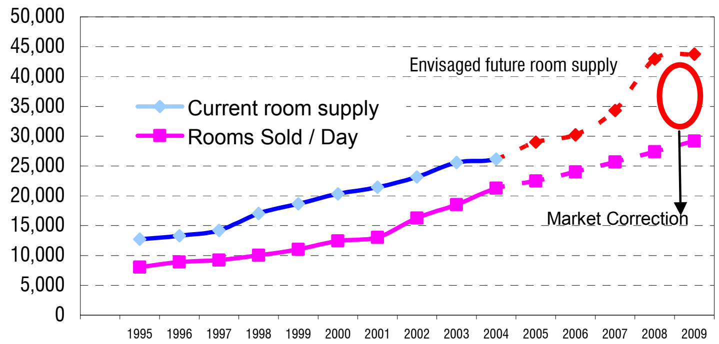
Table 9 Relationship Analysis – Public Spending vs Hotel Demand

Year	Capital Investment (US$ mln)	Growth	Rooms Occupied	Growth
1995	3,258	—	2,932,613	—
1996	3,475	7%	3,256,336	11%
1997	3,589	3%	3,363,505	3%
1998	3,133	-13%	3,653,435	9%
1999	4,002	28%	4,016,414	10%
2000	4,199	5%	4,551,141	13%
2001	4,393	5%	4,763,123	5%
2002	4,822	10%	5,936,003	25%
2003	5,369	11%	6,753,659	14%
2004	5,834	9%	7,754,869	15%
Correlation			**0.98**	



Econometric Forecast

Year	Capital Investment (US$ mln) as per WTTC Report	Projected Rooms Occupied	Assumed Supply Growth	Demand Growth
2005	6,217	8,205,591	10.9%	
2006	6,535	8,760,116	4.2%	7%
2007	6,885	9,370,645	13.4%	7%
2008	7,243	9,994,344	25.3%	7%
2009	7,619	10,651,131	1.9%	7%
2010	8,014	11,340,627	2.0%	6%
2011	8,431	12,068,013	2.0%	6%
2012	8,869	12,831,531	2.0%	6%
Cumulative Growth		**156%**		



Sources: HVS International Research and Analysis; WTTC reports; Dubai Department of Tourism and Commerce Marketing

We make the following comments on Table 9.

- The capital investment figures were provided in the Tourism Satellite Accounting report for the UAE presented by the World Travel and Tourism Council. The capital investment figures are those for the UAE in general and not Dubai in particular. We consider that Dubai, mainly, and Abu Dhabi, to an extent, are the emirates principally attracting public capital investment;
- Our relationship analysis shows that the total number of room nights in Dubai is almost perfectly correlated to the public capital investment (on tourism) in the UAE, at 0.98. In theory, this means that 98% of the total number of rooms occupied (hotel demand) is explained by the amount of capital investment in the UAE. We note that between 1995 and 2004, only once, in 1998, did capital investment decrease;

- In light of the high correlation witnessed, we performed a regression analysis between the two sets of variables. We obtained an R^2 value of 0.95 (the R^2 value is an indicator of how well the model fits the data; an R^2 value of close to 1.0 indicates that we have accounted for almost all of the variability with the variables specified in the model);
- Based on the amount of capital investment in the UAE projected by the WTTC Tourism Satellite Account and our relationship analysis, we forecast room nights for the period 2005-12. Our forecast suggests that for every 1 million AED in capital investment in the UAE, annual room nights are likely to increase by 475. On the other hand our analysis shows that were no capital investment to be made, then the market would lose 26,000 room nights per annum, which clearly demonstrates the significance of the public capital investment (infrastructure, accommodation, and so forth) as a determinant of future demand;
- Using our forecast/relationship equation, and based on the estimated amount of capital spending as per the WTTC, our forecast suggest that room nights should increase by 50% due to the public spending anticipated. We stress that this analysis is a mathematical (econometric/statistical) forecast, and is for indicative purposes only.
- Table 9 shows that in 2008, once the new supply comes on stream, the market performance is likely to be adjusted when compared to its extraordinary current performance (occupancy levels of over 90%), to reach more reasonable performance levels. We note that such dynamics are considered to be natural occurrences in emerging markets such as Dubai.

Synthesis and Conclusion

General Market Performance

- Given the historical growth in hotel demand, the forecast public spending on tourism in the emirate, and the current and future projects that are currently being developed in Dubai we expect demand to experience an average annual growth of 7%-10% over the next five to ten years;
- We expect the hotel market to return a strong operating performance in 2005 and 2006. The market correction is envisaged to take place between 2007 and 2009, once further new supply comes on stream. From 2010 onwards, we expect the market to recover, and occupancy to stabilise at around 70-75%, when compared to the current occupancy levels of approximately 90%;
- We expect the additional supply that will enter the market to put pressure on average room rate. In 2008 and 2009, we envisage that the market will experience a slight decline in average room rate, of approximately 5-10% (for five-star hotels);

- Our projections and conclusions assume that the government will continue to promote and invest significantly in the tourism industry in Dubai.

Opportunities and Appeal

- We consider that, given the current and future supply and demand dynamics of the five-star hotel sector, limited further opportunities exist for the development of such hotels in Dubai. However, opportunities remain for the development of such properties in other key locations in the country;
- We consider that significant opportunities currently exist in the emirate (and country) for the development of branded limited service (or three-star) hotels;
- Opportunities remain for developing extended stay properties in the market;
- Given the increased level of leisure demand in Dubai, opportunities exist for the development of timeshare properties in the market;
- In our opinion, the emerging nature of the residential property market in Dubai, combined with the increased level of demand for hotel assets (together with the increased liquidity in the market), provide opportunities for the development of condominium hotels and other types of shared ownership properties in Dubai;
- We expect that international capital (notably from Asia and Europe) will soon start to be invested in the hotel industry in Dubai. This will be instigated by debt capital, followed by equity capital;
- We expect the hotel lending transaction market in Dubai to be very active over the next 12 months (mainly refinancing deals). We forecast the new lending transactions to have more aggressive terms when compared to the conservative terms of a typical hotel senior loan in the market (and region);
- Short-term cash flow management will be a key area of focus for asset managers over the next five years. In the imminent future, long term financial structuring will remain as the main focus;

About the Authors and the Team

Sarah Leemann is an Associate with HVS International's London office. She joined HVS in the summer of 2004, having worked for two years as a financial analyst for UBS in Switzerland. She holds a Bachelor of Science in Hospitality Management from Ecôle Hotelière de Lausanne in Switzerland. Since joining HVS International, Sarah has conducted numerous valuations, feasibility studies, and market studies in Europe, Middle East and Africa.

Elie Younes is an Associate Director with HVS International's London office, and is jointly responsible for the Middle East and Africa region. He joined HVS International in 2001 having had four years' operational and managerial experience in the hospitality industry in the Middle East. Elie benefits from his diverse multicultural background and speaks Arabic, English and French. He holds a BA in Hospitality Management from Notre Dame University in Lebanon, an MBA from IMHI (Essec Business School, France and Cornell University, USA) and is currently preparing his MSc in Real Estate Investment at Cass Business School in London. Since joining HVS International, Elie has advised on and valued various hotel (single assets, portfolios, and company valuations) resorts, and extended stay projects in Europe, the Middle East and Africa. He has also given strategic advice on mid- and large-scale developments and investment ventures in the Middle East and Africa.

Bernard Forster is a Director with HVS International's London office, heading the Middle East and Africa region together with Elie Younes. He joined the company in 1997 from Accor Hotels & Resorts where he was working in the IT division, focussing on property management systems, yield management systems and guest history systems for Accor Hotels in Europe, the Middle East and Africa. Previously Bernard worked in various operational management roles for the Savoy Group in London (now Maybourne Group) as well as in F&B for the Dolder Grand Hotel in Zürich. Bernard holds an MSc in Property Investment from the City University, London, a BSc (Hons) in Hotel Management from Oxford Brookes University and a diploma in Hotel Administration from Institut Hotelier 'Cesar Ritz', Le Bouveret, Switzerland.

About Our Team

HVS International has a team of Middle East experts operating in the Middle East and Africa (MEA) region, led by Elie Younes and Bernard Forster. The team benefits from international and local cultural backgrounds, diverse academic and hotel-related experience, in-depth expertise in the hotel markets in the MEA region and a broad exposure to international and established hotel markets in Europe. Over the last 24 months, the team has advised on more than 60 hotels or ventures in the region for hotel owners, lenders, private equity funds, investment banks, investors and operators. Together, this team has advised on more than

US$10 billion of hotel real estate. Our services and expertise for the MEA region include:

- Market and financial feasibility studies for all types of hotel derivatives;
- Investment counselling for mid-and-large scale 'hotel' funds;
- Single asset, portfolio, or business/company valuations;
- Operator search and management contract negotiations;
- Asset management and operational audits;
- Assistance on financial structuring and sourcing finance.

For further information about the Middle East markets, please contact Elie Younes or Bernard Forster.

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