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Savills World Research
China

Briefing
Hotel sector

October 2014

Image: The Westin Bund Center Shanghai

SUMMARY

The China hotel market continues to record stable, albeit low, ADR and occupancy levels in most cities. However, growing demand from middle-income earners may present new opportunities for upscale properties.

- Domestic tourism and business travellers are the key drivers of future demand
- RevPAR is under pressure in most cities, with only Beijing and Xiamen recording growth over the last year compared to the previous three years
- F&B revenue fell 11% year-on-year (YoY) in 2013 but still accounts for 42% of overall hotel revenue
- Opportunities for growth exist in the resort and upscale hotel segments
- Companies are expected to continue expanding into second tier cities in search of new growth opportunities

"Domestic tourism has irrefutably replaced international tourism as the key driver of demand for all sectors of the hospitality industry." James Macdonald, Savills Research

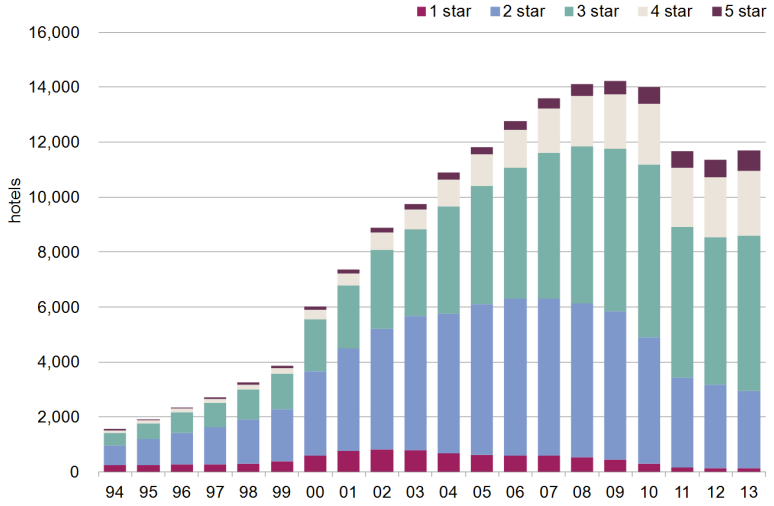
According to the China National Tourism Administration (CNTA), China had 11,687 star-rated hotels by the end of 2013, down from 14,237 hotels in 2009. Of those rated in 2013, 6.3% were rated five-star and 20.2% -four-star.

The data provided, in terms of the number of star-rated hotels, is in stark contrast to what is generally accepted about the hotel industry in China –namely that the hotel market is continuing to grow at a rapid pace. This is especially true for the internationally-branded upscale sector as international operators continue to expand their China-wide operations.

One of the main reasons for this inconsistency is that some hotels have decided to forego the rating system. Reasons vary but some factors to be considered are:

GRAPH 1

China star rated hotels



Source: China National Tourism Administration; Savills Research

- Different criteria – hotels where the accommodation, services and facilities are rated as five-star overseas, may not be so rated in China (and vice versa); operators and owners may prefer not to be rated at all

- The government's new policy on cutting down extravagant spending has hotel owners perhaps deciding to reduce the star-rating of the hotel. This isn't possible when taking part in the national rating system

- Owners may not want to adhere to the government star-rating criteria due to a rise in the costs of construction.

- The star-rating status is not seen as contributing directly to occupancy and room rate, or to the bottom line

- Hotels can only be star-rated after one year's operation

- According to the China Classification & Accreditation for Star-rated Tourist Hotels, 2010 hotels will need to apply to renew their rating every 5 years.

- Fit-out costs will increase as the star-rating goes up, due to the requirements for higher-quality services and facilities. Procurement of general hotel fit-out necessities, such as bedding, furniture and carpets, as well as high-end property management systems, will also push up final costs.

The above data is primarily drawn from government data categorizing the information by star-rating. However, some major players in the market are opting out of being rated, and as such the data is probably not indicative of the overall market.

Drivers

Historically, the biggest driver in China's hotel market, especially the luxury segment, was international tourism. International and compatriot (citizens of Hong Kong, Taiwan and Macau) tourism in China increased from 44 million person times[1] in 1994 to 131 million person times in 2007, a CAGR of 8.9%. Since then, the numbers have plateaued, ending 2013 at 129 million person times.

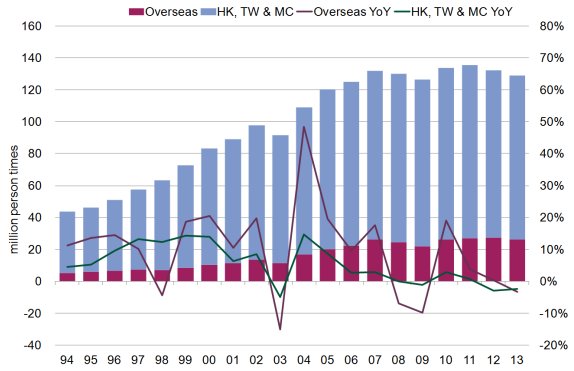
Following the global economic slowdown, foreign business travellers have increasingly opted for more affordable hotels as central management reviews and cuts down on business expenses. This is believed to be especially true for travellers from particular countries, such as Japan.

Conversely, domestic tourism has accelerated in recent years; domestic tourism accounted for 524 million person times in 1994, and with a CAGR of 9.0%, reached 1.6 billion by 2007, echoing the growth trend seen by the international segment.

1 China National Tourism Administration defines 'person times' as the number of trips taken, not the number of people travelling.

GRAPH 2

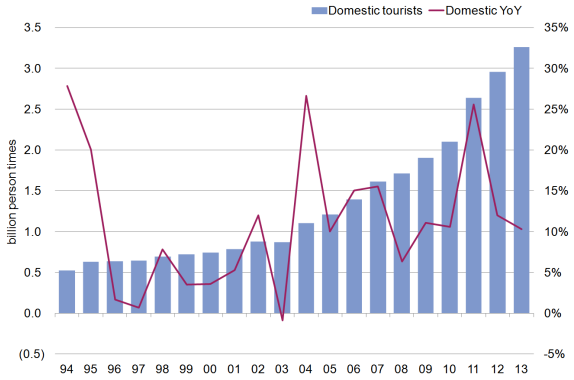
Overseas and compatriot tourism*



Source: China National Tourism Administration; Savills Research
* HK, TW & MC – Hong Kong, Taiwan and Macao

GRAPH 3

Domestic tourism



Source: China National Tourism Administration; Savills Research

However, unlike the international segment, domestic tourism has grown at a CAGR of 12.5% since 2007, reaching 3.3 billion person times by 2013. While much of this tourism may be accounted for by migrant workers of less than 6 months, the figures point to significantly increased mobility in the last seven years, of which at least part will need to be supported by short-term accommodation providers.

Domestic tourism is, understandably, significantly larger than the international market, with 3.3 billion person times compared with 140 million person times. The difference in figures has been exacerbated over the last six years due to different growth rates within these segments.

As mentioned previously, much of the domestic tourism can be accounted for by trips made by migrant labour pools visiting their home towns, especially during the Chinese New Year and October National Days, when it is estimated that more than one hundred million migrant labourers return home. This segment of domestic tourism is obviously difficult to capture from a hotel perspective.

There are two key areas which a number of operators are currently targeting`– the domestic business traveller segment, and sightseeing and holiday[2] segment. The business traveller segment has grown exponentially in recent years as companies grow their geographical footprints and China becomes more connected. The sightseeing and holiday segment is well-established yet evolving, from less city sightseeing tour operators to more resort-focused holidays. Medical tourism in China has yet to take off, with the general quality of medical facilities unable to compete with neighbouring countries such as Thailand, Taiwan and South Korea.

In contrast to other international markets, where the luxury hotels tend to have fewer numbers of rooms for more guest exclusivity and to ensure an unparalleled service level, China luxury hotel developments on average tend to have larger room sizes, more room inventory, larger function spaces and more facilities, irrespective of the potential demand level for the city. This can partly be explained by the fact that the cost of development and construction time is significantly lower than in other markets. However, this impacts the guest experience, resulting in sub-par provisions and inconsistent service levels at many of the larger hotels, leading to low occupancy and RevPar in various cities across China. Another factor is that many of the five-star boutique hotels in China are not officially star-rated.

2 The China National Tourism Administration defines sightseeing and holiday segments as subcategories of the leisure segment

F&B revenue in China hotels have achieved CAGR 7.2% from 2008 to 2013, in comparison to 4.1% accumulated annual growth rate for room revenue. Previously, the hotels in China were built with a significant number of F&B outlets and plenty of seating capacity, however, the more newly-built hotels are reducing the number and size of food and beverage outlets per hotel, and focusing more on the quality and offerings to obtain higher F&B spend per guest, and profitability. In terms of demand for hotel F&B in China, the increasing levels of disposable income and enlargement of the middle-class segment of the population, has created positive demand for more variety of F&B options, creating a steady growth of F&B revenue over the last few years. This trend is expected to continue, however, the central government policy on anti-corruption and direction to eliminate extravagant spending has impacted the F&B revenue for hotels, which has declined by 11% for 2013 compared to 2012.

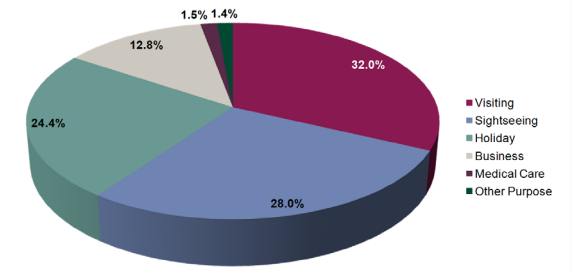
RevPAR rates have trended down across the board over the last 18 months after having plateaued for the previous three years (as far back as the quarterly CNTA data goes).

This could be partly as a result of the anti-corruption campaign that was initiated in Beijing but has spread to the rest of the country, but it could also be as a result of the general economic slowdown which is currently being witnessed in China. This has resulted in companies becoming more cost-conscious, with part of that saving correlating to business travel expenditure.

Coastal cities, key economic cities and business centres tend to be head and shoulders above other cities

GRAPH 4

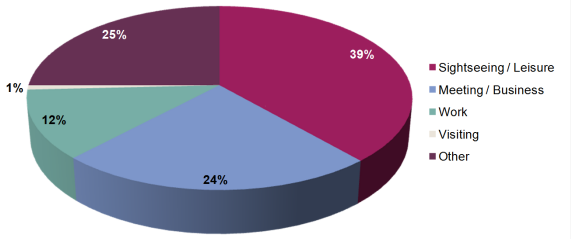
China star rated hotels



Source: China National Tourism Administration; Savills Research

GRAPH 5

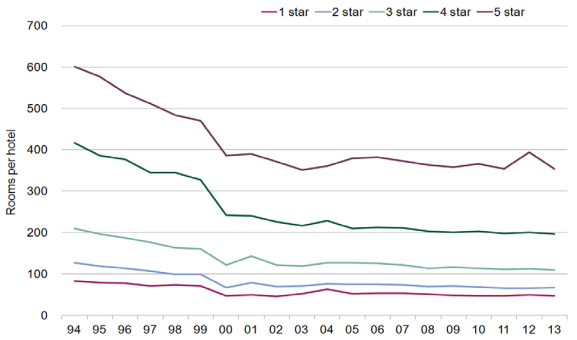
International (incl. compatriot) tourism by purpose, 2013



Source: China National Tourism Administration; Savills Research

GRAPH 6

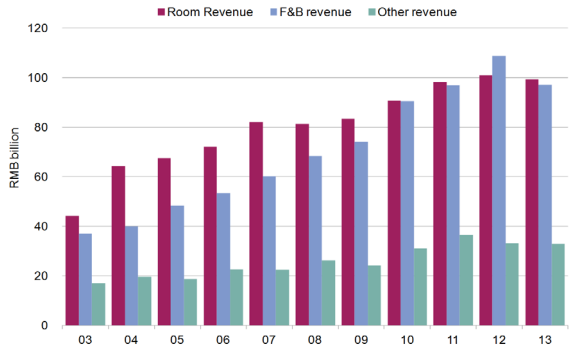
No of rooms per hotel by hotel rating



Source: China National Tourism Administration; Savills Research

GRAPH 7

Hotel revenue by source



Source: China National Tourism Administration; Savills Research

in terms of RevPAR. This can be attributed to continuous high demand in the areas, allowing operators to maintain their higher price levels. As emerging cities develop and infrastructure is improved, demand may grow, causing the rates in these areas to increase.

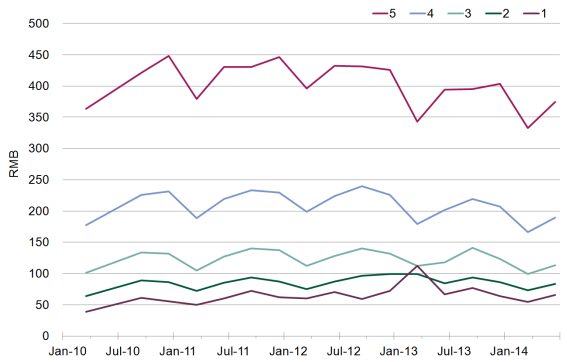
Larger markets such as Shanghai (6.4%) and Beijing (0.2%) have seen a slight upturn in RevPAR rates YoY, while more mid-size markets have generally seen a slight decrease. Even Sanya, the best performer in terms of RevPAR, has seen a moderate decrease of 4.7% YoY.

Only two of the larger five-star markets, Beijing and Xiamen, have seen an improvement in RevPAR levels when comparing the last 12 months to the previous three years' worth of data. Beijing RevPAR increased 3.5% thanks to an increase of 3.8% in ADRs, while Xiamen increased 0.9% due to moderate growth in both ADR and occupancy rates. The biggest decreases were recorded in Xi'an and Urumqi.

The hotel investment market has seen an increase in activity over the last year as developers look to offload non-core stock – both in terms of location and asset class. Several deals have been concluded by owner-operators, institutional investors, or, in the case of Shanghai in recent quarters, investors looking to convert hotel space for other usage. Notable

GRAPH 8

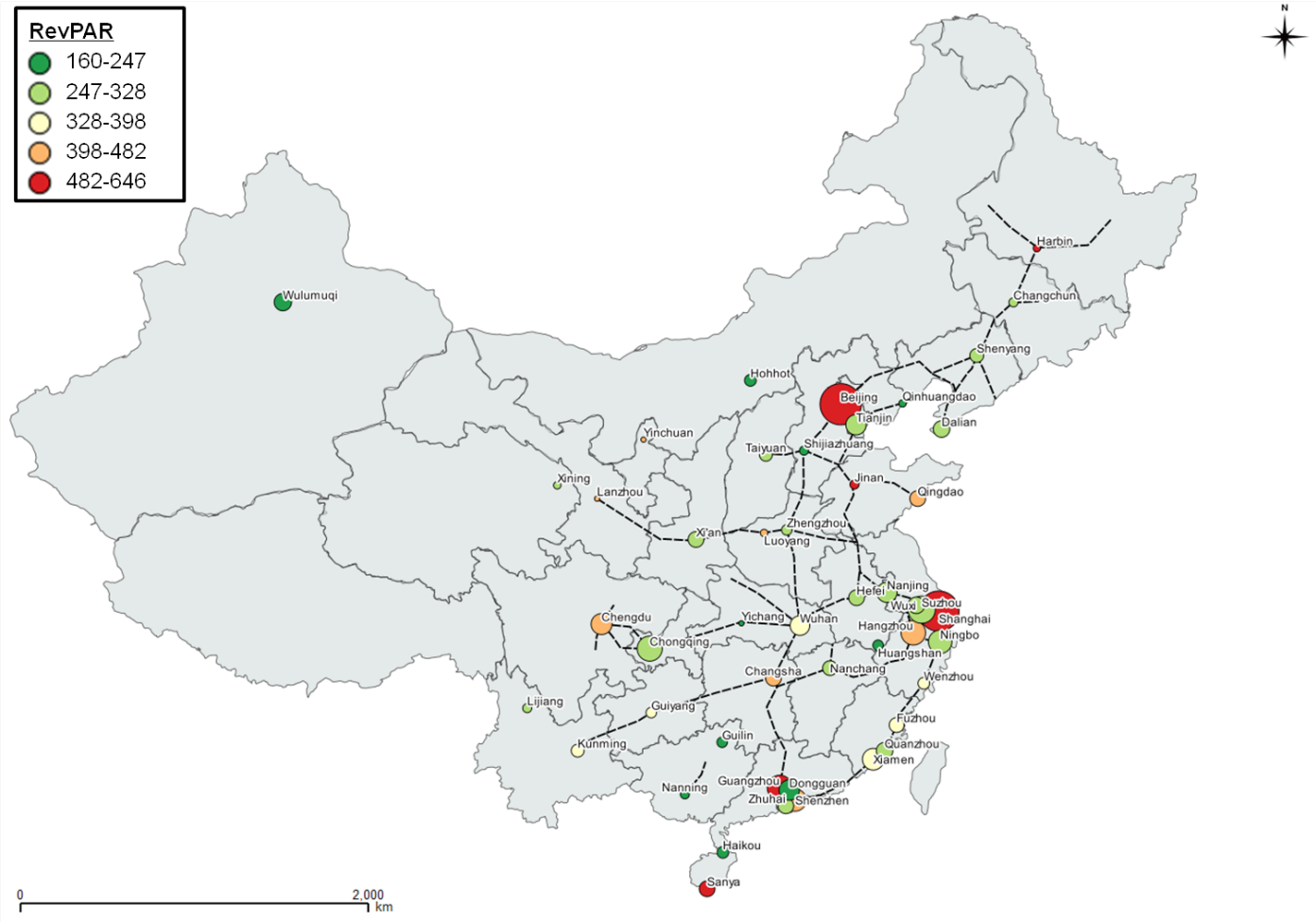
China-wide hotel RevPAR by star rating



Source: China National Tourism Administration; Savills Research

GRAPH 9

5 Star Hotel RevPAR, Q2/2014



Source: China National Tourism Administration; Savills Research

deals in Shanghai have included Galaxy Hotel, JC Mandarin and Tomorrow Square, all rumoured to be being converted into office space.

Market Outlook

Until recently, China's hospitality market has been dominated by the development of large hotel projects targeting the luxury segment. Part of the reasoning behind this was the misguided belief by some developers and investors that higher-positioned projects would mean faster ROI, leading to a more profitable and valuable project. A further factor was that municipal and district governments in land planning documents would sometimes stipulate that a five-star hotel would have to be built on a particular development site to act as a status symbol for the district and to provide facilities for government and business functions – even when the location and scale sometimes meant that the properties would not be commercially viable.

These government bodies and developers/investors are now becoming more realistic, looking more closely at where demand is coming from and what type of facilities are required to meet this demand. Consequently, the market will begin to focus more on both budget and upscale segments of the market, catering to the growing needs of an increasingly mobile middle class and local mid-management workforce.

Aside from more affordable short-stay options, there is growing demand for resorts and boutique hotels as the middle class become wealthier, better travelled and more urbane, looking for more experiential travel.

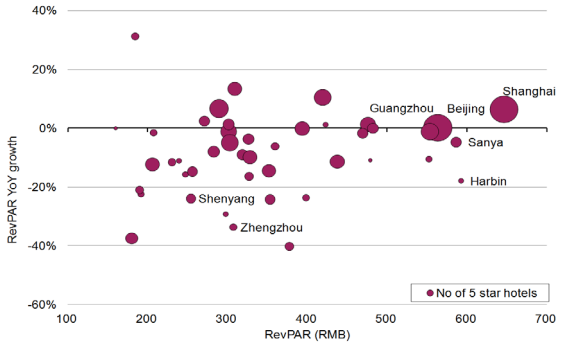
One of the biggest obstacles faced by hotel operators, apart from oversupply and profitability, is management standards. The spectacular growth in the hospitality market, and competition for employees from other service sectors, has meant a mismatch between supply and demand for service employees, making staff training costly and retention problematic.

As with many industries currently growth opportunities in the four first-tier cities are now scarcer, while the multitude of second- and third-tier cities present an eye watering opportunity for those brave enough – and with the financial capacity – to explore them. Nevertheless, not all lower-tier cities are the same, and developers/investors/operators would do well to fully research opportunities before making any commitments.

As domestic developers and operators get closer to international standards, there may also be opportunities for some firms to expand beyond the national borders and join the ranks of Chinese firms and individuals exploring opportunities in overseas markets. Recent examples of this growing but still nascent trend include Dalian Wanda, who have acquired a number of development sites with hotel components, and Jin Jiang Hotels who acquired a 50% stake in Interstate Hotels & Resorts in 2009, and have plans to expand their network into Indonesia, opening at least 30 Jinjiang brand hotels through a licensing agreement with local partner PT. Marindo Investama.

GRAPH 10

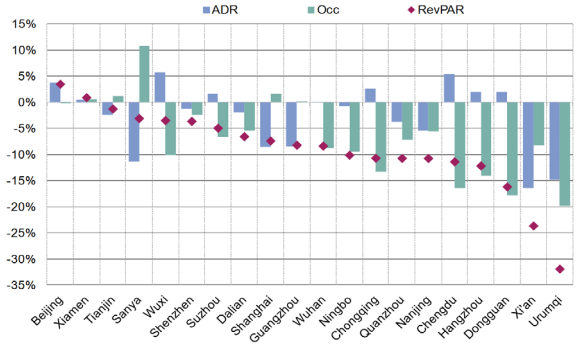
5 Star Hotel RevPAR, Q2/2014



Source: China National Tourism Administration; Savills Research

GRAPH 11

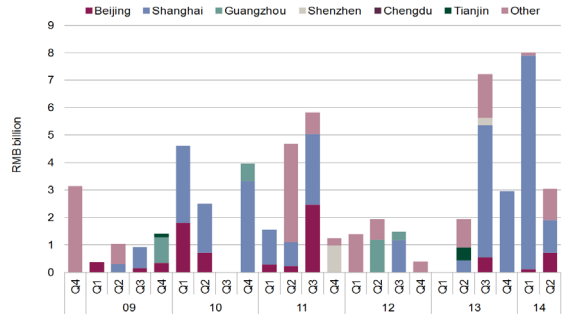
last 12mths vs previous three years



Source: China National Tourism Administration; Savills Research

GRAPH 12

China-wide hotel sizeable investment deals



Source: Real Capital Analytics; Savills Research

TABLE 1

Key selected new supply 2014 – 2017

English name	Chinese name	Brand	Launch date	# rooms
Sofitel Kunming	昆明昆钢索菲特酒店	Accor S. A.	2014	405
Mövenpick Sanya, Phoenix Island	凤凰岛瑞享度假村	Mövenpick	2014	380
Double Tree by Hilton Xiamen	厦门海沧正元希尔顿逸林酒店	Hilton	2015	262
InterContinental Shimao Shanghai	上海世茂新体验洲际酒店	IHG	2015	370
Mandarin Oriental Chongqing	重庆文华东方酒店	Mandarin Oriental	2016	231
Conrad Guangzhou	广州康莱德酒店	Hilton	2016	306
Hyatt Regency Shenzhen Yantian	深圳盐田凯悦酒店	Hyatt	2017	299

Source: Company websites; Savills Research

TABLE 2

Selected mainland China hotel & serviced apartment investment transactions Dec 2013 – Aug 2014

Tenant	City	Units	Consideration (RMB million)	Cost per unit (RMB million)	Date	Buyer
Marriott Executive Apartments (F7-22, F24-32)	Shanghai	231	2,386.0	10.3	Mar-14	Guo Sheng & Shen Di
Shanghai JC Mandarin Hotel	Shanghai	514	2,118.0	4.1	Jan-14	Baohua
Shama Century Park	Shanghai	284	1,734.4	6.1	Dec-13	Metro Holdings Limited
The HUB (Hotel)	Shanghai	403	1,420.4	3.5	Feb-14	Brookfield Asset Mgmt
Galaxy Hotel	Shanghai	666	1,262.5	1.9	Jan-14	YangGuang
Amenity Garden	Shanghai	500	1,216.3	2.4	Dec-13	Angelo Gordon
Pacific Century Place Apartments	Beijing	200	722.4	3.6	Apr-14	Gaw Capital
Regal Jinfeng Hotel	Shanghai	372	600.0	1.6	Jan-14	Shanxi Dongxiang
Golden City Garden	Shanghai	120	588.2	4.9	Apr-14	HKR International Ltd
La Palazzo Hotel, Maoming	Maoming	299	584.5	2.0	May-14	Ceneric (Holdings) Ltd
Shama Luxe Grand Central Serviced Apartment	Dalian	195	571.0	2.9	Jun-14	Ascott Residence Trust
Holiday Inn Downtown Beijing	Beijing	343	554.2	1.6	Aug-14	Beijing Properties (Hldgs)
Citadines Gaoxin Xi'an	Xian	248	169.8	0.7	Aug-14	Ascott Residence Trust
Citadines Zhuankou Wuhan	Wuhan	249	155.6	0.6	Aug-14	Ascott Residence Trust

Source: Real Capital Analytics; Savills Research

Definitions:

The largest five star markets cover the top 20 cities and include in order of size: Beijing, Shanghai, Suzhou, Guangzhou, Chongqing, Hangzhou, Ningbo, Shenzhen, Xiamen, Chengdu, Tianjin, Nanjing, Dongguan, Wuhan, Wulumuqi, Wuxi, Quanzhou, Dalian, Xi'an, and Sanya

Luxury – 5 star Upscale – 4 star

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