

Briefing Hotel sector

August 2015



Image: Banyan Tree Sanya

SUMMARY

In order to remain competitive within a constantly evolving market, hotels are being pressured to diversify their offering to appeal to a wider target audience.

■ Q4/2014 saw national average daily rates (ADR) fall 5.3% year-on-year (YoY) to RMB659 per night, also down 11.4% when compared to the Q4 average for the previous four years (2010-2014).

■ China-wide five-star hotel occupancy rates remained unchanged YoY at 57.9%, though they remain down 3.9 percentage points when compared to the Q4 four-year average.

■ China-wide RevPAR fell 5.3% YoY to RMB382 per night by the end

of 2014, down 11.4% compared to the Q4 four-year average.

■ The growth of domestic tourism across China has evolved alongside developers and the government planning new cities across the nation. This has allowed hotel operators to seek new opportunities in diversifying their brands beyond first-tier cities in China.

■ Domestic tourism continues to grow and remains a key driver of future demand, having risen to 3.6 billion person times in 2014, up 10.7% YoY.

“Where, traditionally, business hotels would have been popular, the leisure sector has been emerging in the last few years.”

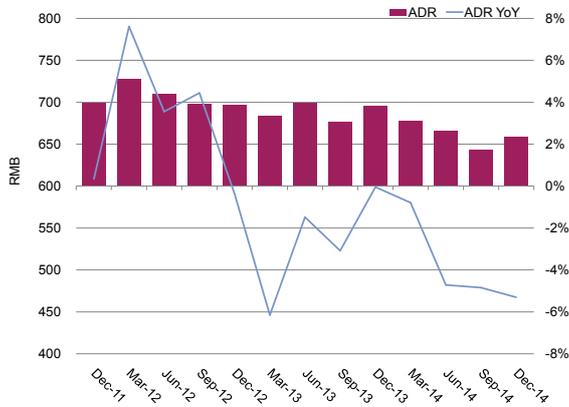
James Macdonald, Savills Research

→ China-wide hotel market overview

The hotel market in China has seen remarkable growth over the last decade. Key events such as the Olympics and the Expo have propelled China into its new position as the largest tourism hub in Asia and fourth largest in the world, according to 2013 Graphs provided by the United Nations World Tourism Organisation (UNWTO). This increase in demand in recent years has meant a diversification in the types of hotels entering the China market.

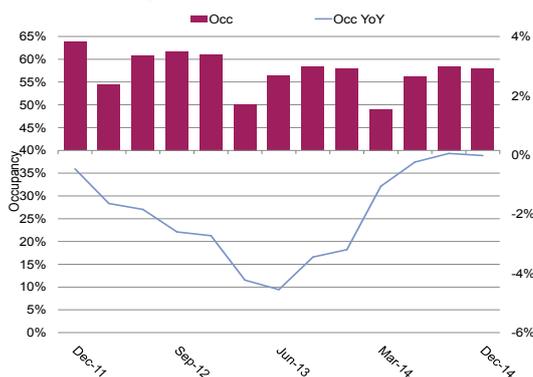
Traditionally, the market has been split between business hotels in leading cities such as Shanghai and Chongqing, and leisure hotels in tourism focused cities such as Xi'an and Sanya. Disposable income growth and a larger middle class,

GRAPH 2 China five-star ADR and YoY change Q4/2011 – Q4/2014



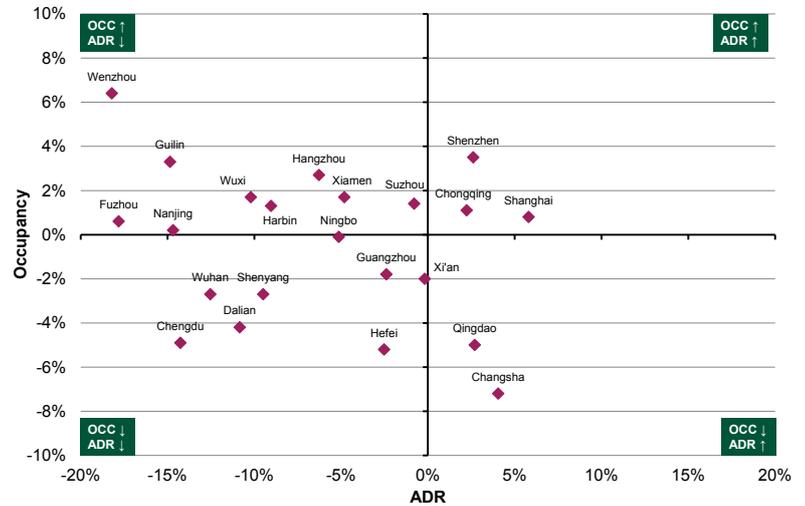
Source: China National Tourism Administration; Savills Research

GRAPH 3 China five-star Occupancy Rates and YoY change, Q4/2011-Q4/2014



Source: China National Tourism Administration; Savills Research

GRAPH 1 China cities five-star ADR and Occupancy YoY change Q4/2013 – Q4/2014



Source: China National Tourism Administration; Savills Research

however, has changed the way people perceive domestic travel, shifting towards more of a balance between business and leisure.

The increase in domestic tourism has allowed hotel management companies and developers to begin diversifying hotel offerings in specific hotel markets in various cities across China.

Where, traditionally, business hotels would have been popular, there has been a distinct growth of the leisure segment, allowing for alternative hotels to be brought onto the market in the last few years, such as the Puli Hotel and Spa in Shanghai and The Opposite House in Beijing.

National average daily rates (ADR) (Graph 2) fell by 5.3% YoY to RMB659 per night. This can be attributed to particular circumstances, namely the Chinese New Year holiday which fell earlier in 2013, allowing for the traditional 40-day travel period for the holiday to fall a lot closer to the end of the previous year.

Sluggish demand, especially from the business and government sectors, amid a steady stream of supply in the last five years has pushed down ADRs. In order to remain competitive within a constantly evolving market with increased competition, hotels are

under pressure to be more innovative and diversify their product and services to appeal to a wider target market. Doing so successfully will enable ADR to gradually improve.

China-wide occupancy rates in five-star hotels (Graph 3) remained unchanged YoY by the end of 2014, at 57.9%. Despite signs of recovery, rates are expected to face further downward pressure in 2015 due to the anti-corruption scheme gaining momentum and a decline in the revenue generated from government sectors.

The government anti-corruption initiative has restricted entertainment spending by government officials, impacting all the revenue streams for four- and five-star hotels. This has been reflected in the decline of ADR, occupancy, RevPAR and F&B Revenue. Where once F&B accounted for a major proportion of the hotel's total revenue, restrictions in government spending for entertainment, and consumers' shift in consumption habits, has had upscale hotels looking for opportunities to transform and position themselves in new target markets to recreate the same profit margins.

China-wide RevPAR (Graph 4) fell 5.3% YoY at RMB382. It is also down 11.4% when compared to the

→ Q4 four-year average. As a result of slower economic growth and a shift in consumer habits, RevPAR is expected to continue its decline in 2015. Despite this, first-tier cities such as Shanghai and Shenzhen saw YoY increases of 7.1% and 8.0%, respectively, up 0.4% and 4.8% compared to the Q4 four-year average, while RevPAR in tourist hub Sanya rose a significant 22.7%, up 10.5% compared to the Q4 four-year average.

First-tier city focus: Shanghai

As one of China's most significant economic centres and its financial hub, Shanghai has long been a major gateway to China for businesses and travellers alike. As a result, the hotel market saw rapid development in the late 1990s and early 2000s as internationally-renowned brands looked to capitalise on the city's growth. A surge in supply was seen in the years leading up to 2010 as the World Expo added credibility to Shanghai as a top destination for large-scale international events.

International sporting events include the Shanghai Rolex Masters, Shanghai ATP Masters 1000, "HSBC Cup" Golf World Championship, and F1 Grand Prix, to name but a few. There are also a large number of MICE businesses hosted in Shanghai, with more expected upon the completion of the 500,000 sqm exhibition centre in the Hongqiao transportation hub. In addition, the development of year-round attractions such as China's first Disneyland and Oriental DreamWorks Studios should continue to draw in tourists and business travellers throughout the year.

While the total number of hotel rooms registered with the Shanghai Municipal Tourism Administrative Commission has only increased by 5.5% over the last five years (Graph 5), the number of four- and five-star hotel rooms has increased by 16.1% and 60.5% respectively. At the same time the number of one-, two- and three- star rooms has declined by 27.2%, 50.7% and 50% respectively. While it is certainly the case that the proportion of hotel rooms rated four- and five-star has increased, these

figures may be inaccurate as several hotels choose to remain unrated.

With several new projects in the pipeline over the next five years, the number of hotel rooms in the four- and five-star categories is expected to increase exponentially, despite a slowdown in global economic conditions. According to research conducted by STR Global at the end of 2014, 27% of room supply from 2015-2019 is expected to be four-star, with 23% dedicated to five-star.

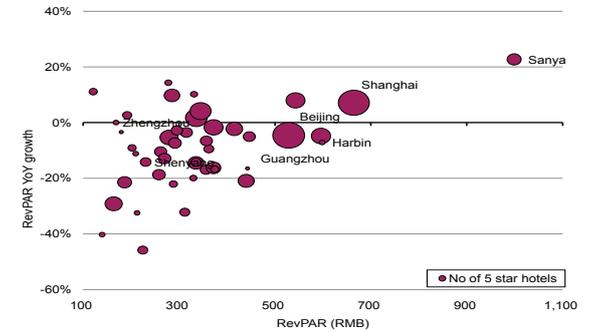
The city-wide ADR for star-rated hotels (Graph 6) stood at RMB671 in Q4/2014 up 5.5% YoY, though this is up 2.5% compared to the Q4 four-year average. While the three-, four- and five-star markets remained relatively stable over the last three years, with a slight increase recorded in 2014, rates still remain roughly 20% below levels seen during the Expo in 2010. In the five-star market, it is roughly 40% below the peak levels seen back in 2006. Shanghai has yet to recover from the overbuild resulting from the run up to the Expo, and while prior to that influx of supply Shanghai had some of the highest ADRs in the country, the premium that Shanghai can now charge over other cities is now much more limited.

City-wide occupancy rates for star-rated hotels (Graph 7) stood at 67.3% in Q4/2014, an increase of 3.0 percentage points (ppts) YoY and up 6.9 ppts compared to the four-year Q4 average. Five-, four- and three-star rated hotels were up 0.9 of a ppt, 4.0 ppts and 5.0 ppts YoY respectively.

While all star-rated hotels recorded increases in occupancy, growth in the last four years has been strongest in the four-star segment, with Q4/2014 figures up 5.6 ppts compared to the Q4 four-year average. While four-star occupancy rates were lower than five-star in 2011, by the end of 2014, four-star occupancy rates stood at 66.5% versus 62.6% in five-star hotels.

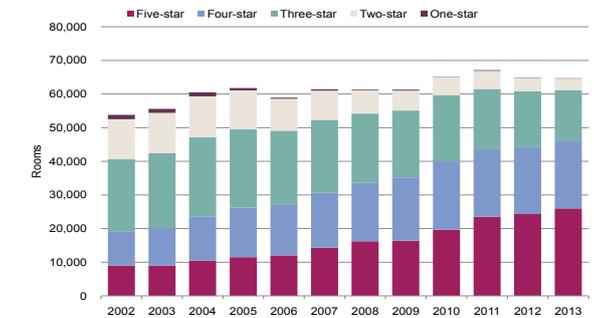
While the market is highly sensitive to seasonality, occupancy rates in general are expected to continue to trend upwards as demand increases

GRAPH 4 China five-star RevPAR and YoY change, Q4/2013 - Q4/2014



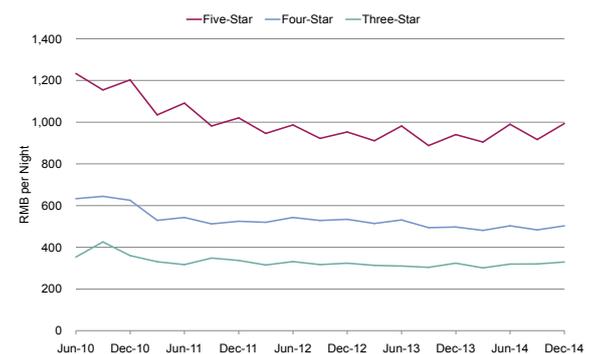
Source: China National Tourism Administration; Savills Research

GRAPH 5 Shanghai Hotel Room Numbers by Star Rating, 2002-2013



Source: Shanghai Statistics Bureau; Savills Research

GRAPH 6 Shanghai five-, four- and three-star hotel ADR, Q2/2010-Q4/2014



Source: Shanghai Statistics Bureau; Savills Research

and China becomes a larger tourism hub.

RevPAR (Graph 8) recorded modest signs of improvement in the last year, thanks in large part to the improvement in occupancy rates. This is in contrast to the previous two years where RevPAR remained flat. Compared to the bottom of the

market, three- and four-star RevPAR was roughly 30% higher in 2014, compared to being just 11% higher in the five-star segment.

Second-tier city focus: Sanya

Sanya, known as the “Oriental Hawaii”, is China’s most developed tourist destination. International tourism to Sanya peaked in 2011 and in 2014 fell by 19.4%. This trend looks set to continue as international tourists opt for ex-China R&R vacations. This is not a big loss for the Sanya market, however, as domestic tourism (which accounts for 97.1% of all tourists to Sanya) continues to grow at a fast pace, exceeding 13 million person times in 2014, up 11.3% YoY. Key international events being held in Sanya recently included the Volvo Ocean Race and Miss Tourism International.

By the end of 2014, Sanya had 12 five-star hotels and 16 four-star hotels. The Sanya hotel market can be broken down into three key established areas, namely Sanya Bay, Dadonghai and Yalong Bay, with each area targeting different audiences.

Sanya Bay focuses on value for money hotels such as Howard Johnson, Four Points by Sheraton and the Pullman. Dadonghai is known as Sanya’s CBD with hotel offerings such as Intercontinental, Marriott and the Mandarin Oriental. Yalong Bay is a mature market and offers mostly upscale, internationally-branded resorts, and boasts the highest ADR in Sanya.

The drive to position itself as China’s leading beach resort has encouraged prolific development in the hotel industry in recent years. New developments are expected to focus heavily upon the Haitang Bay area, with limited land available for development in the three key locations. Haitang Bay already has a Shangri-La, Conrad and Kempinski, with another six developments expected to join them in 2015.

Sanya boasted the highest five-star ADR in China (Graph 9) at RMB1,397 in Q4/2014, up 23.1% YoY and up 7.9% compared to the four-year Q4 average. With a large number of

projects coming onto the market in the next few years, five-star ADRs could see a lift as a significant portion of these are internationally-renowned, luxury brands.

Sanya is highly sensitive to seasonality, with the first quarter generally considered to be the peak season for tourism due to the climate and the Spring Festival Holiday. Occupancy levels (Graph 10) peak in the first quarter and are typically 15-20 % higher than the second and third quarter.

While all three sector occupancy rates fell in Q4/2014, three-star occupancy rates saw the largest decrease YoY, dropping 1.5 ppts to 57.4%. Five- and four-star occupancy rates in Q4/2014 stood at 71.5% and 66.1%, down 0.3 and 0.1 of a ppt, respectively.

Five-star RevPAR rates (Graph 11) stood at RMB999 in Q4/2014, up 22.7% YoY and up 10.5% compared to the four-year Q4 average. This can be attributed to the significant increase in ADR seen in 2014, despite the marginal drop in occupancy rates.

Market news

InterContinental Hotels Introduces a Luxury Hotel Brand for China
Intercontinental Hotels Group (IHG) introduced Hualuxe Hotels, a luxury brand of hotel catering to Chinese travellers in China. With outbound travel becoming more popular, IHG is aiming to build brand image and loyalty in the domestic market in an effort to target outbound travellers.

The brand was developed to incorporate more of a Chinese feel than IHG’s other internationally-branded hotels and each property is designed using more traditional Chinese styles as well as incorporating extras such as tea rooms. IHG hopes to develop at least 100 hotels in the next 20 years across China as well as popular international tourist destinations such as Paris, London and New York.

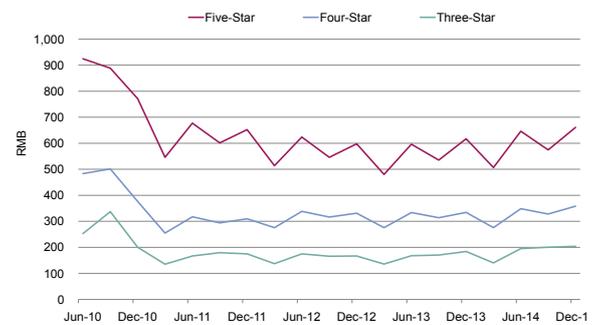
This announcement comes after a number of domestic brands such as the Jinjiang Hotels Group, which already has a strong reputation

GRAPH 7
Shanghai five-,four- and three-star hotel occupancy rates,Q2/2010-Q4/2014



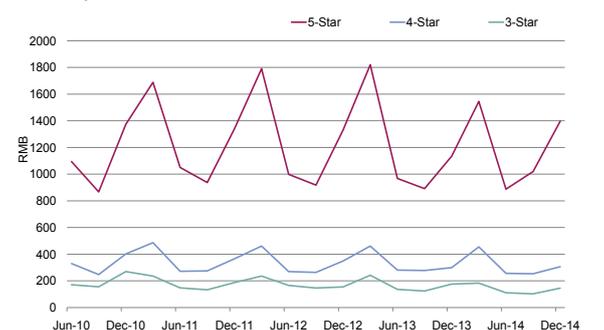
Source: China National Tourism Administration; Savills Research

GRAPH 8
Shanghai five-,four- and three-star hotel RevPAR, Q2/2010-Q4/2014



Source: Shanghai Statistics Bureau; Savills Research

GRAPH 9
Sanya five-,four- and three-star hotel ADR,Q2/2010-Q4/2014



Source: Shanghai Statistics Bureau; Savills Research

TABLE 1
Sanya tourism figures

	International	Domestic
2005	211,980	3,853,909
2009	317,833	6,382,732
2010	415,143	8,411,367
2011	528,077	9,681,767
2012	481,437	10,540,791
2013	481,851	11,802,126
2014	388,600	13,139,000

Source: Savills Research

within the China market, have begun operating hotels overseas. Recognising the potential in the market, Hualuxe will attempt to respond to demand for luxury travel with a more Chinese feel. This move towards a more domestic market could mean IHG gains a larger market share, with brand recognition spilling over onto its other brands. Hualuxe has already announced two projects – one in Nanchang (281 rooms) and another in Yangjiang (282 rooms).

Market Outlook

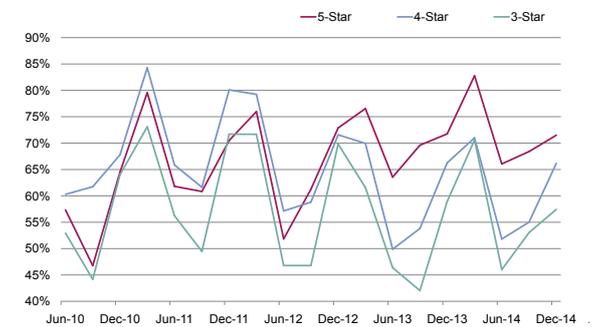
With rising wealth, more diverse tastes and continuous improvement in the hotel/resort market and its supporting infrastructure, domestic tourism is expected to grow even more. Domestic tourism numbers in 2014 already registered a significant increase of 10.7% to 3.6 billion person times. Outbound tourism is growing even faster (up 18.7% to 117 million person times), accounting for the equivalent of 3.2% of the domestic market. Operators are exploring ways to strengthen their brand in China not only for the sake of their China market share, but also to secure partnerships with local developers as they go

overseas and capture a share of the increasing outbound market.

While markets like Shanghai are already fairly mature, diversification in terms of consumption trends is expected to see these markets receive projects that wouldn't traditionally have been introduced in that location, such as spa hotels and themed hotels. Markets like Sanya where tourism is a pillar industry, however, are expected to see a less diversified supply as similar operators enter the market in an effort to capitalise on the growing domestic tourism market.

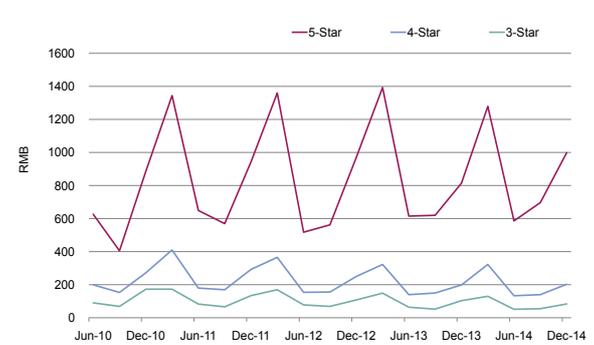
With hotel markets sensitive to seasonality, occupancy rates will always fluctuate over the course of a year. However, due to increasing tourism numbers domestically and the beginning of a recovery in the Chinese economy, occupancy rates are expected to trend upwards overall. Where traditionally higher occupancy rates were seen in five-star hotels, this may shift towards the four-star market, as seen in Shanghai this year, due to the continued crackdown on extravagant spending and a shift in consumer habits. ■

GRAPH 10
Sanya five-, four- and three-star hotel occupancy rates, Q2/2010-Q4/2014



Source: China National Tourism Administration; Savills Research

GRAPH 11
Sanya five-, four- and three-star hotel RevPAR rates, Q2/2010-Q4/2014



Source: China National Tourism Administration; Savills Research

TABLE 2
Selected mainland China hotel & serviced apartment investment transactions, 2014

Tenant	City	Units	Consideration (RMB million)	Cost per unit (RMB million)	Date	Buyer
Shanghai JC Mandarin Hotel	Shanghai	514	2,118	4.1	Jan-14	Baohua
Galaxy Hotel 銀河賓館	Shanghai	666	1,262.5	1.9	Jan-14	YangGuang
Regal Jinfeng Hotel	Shanghai	372	600	1.6	Jan-14	Shanxi Dongxiang
Amanfayun	Hangzhou	47	103.4	2.2	Feb-14	Adrian Zecha JV Peak Hotels
Aman Hotel at Summer Palace	Beijing	51	112.2	2.2	Feb-14	Adrian Zecha JV Peak Hotels
Egang Hotel	Wuhan	159	91	0.6	Feb-14	Wuhan 2049 Development & Investment Co Ltd
Marriott Executive Apartments (F7-22, F24-32)	Shanghai	231	2,386	10.3	Mar-14	CEFC
Pacific Century Place Apartments	Beijing	200	722.4	3.6	Apr-14	Gaw Capital
Golden City Garden	Shanghai	120	588.2	4.9	Apr-14	HKR International Ltd
Shama Luxe Grand Central Serviced Apartment	Dalian	195	571	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
Hilton Guangzhou Tianghe	Guangzhou	498	1,690	3.4	Dec-14	Jinyinfeng Equity Investment Fund (SZ)

Source: Real Capital Analytics; Savills Research

TABLE 3
Key selected new supply 2015 – 2018

English name	Chinese name	City	Brand	Launch date	#rooms
Four Seasons Tianjin	天津四季酒店	Tianjin	Four Seasons	2015	248
Shanghai Tower J Hotel	上海中心J酒店	Shanghai	Jinjiang Hotels	2015	258
Jumeirah Guangzhou Hotel	广州卓美亚酒店	Guangzhou	Jumeirah Group	2015	207
Mandarin Oriental Chongqing	重庆文华东方酒店	Chongqing	Mandarin Oriental Hotel Group	2016	231
Waldorf Astoria Chengdu	成都华尔道夫酒店	Chengdu	Hilton Worldwide	2016	300
AtlantisSanya Haitang Bay	三亚兰蒂斯度假村	Sanya	Atlantis Resorts	2016	1,300
Bellagio by MGM Beijing	北京宝丽嘉酒店	Beijing	MGM Resorts International.	2018	230

Source: Company websites; Savills Research

Project focus

W Shanghai – The Bund



Located in the up-and-coming North Bund area, the W hotel will offer uninterrupted views of Shanghai's iconic Lujiazui skyline. The project will offer 383 rooms as well as a spa and will incorporate W hotel's famous Whatever/Whenever service philosophy. Slated for launch in early 2017, the project will be a component of the Sinar Mas Centre developed by Sinar Mas Group - APP China. This mixed-use development will also house office and retail space as well as event facilities and a cinema.

GRAPH 12
W Shanghai – The Bund

Location	Sinar Mas Centre – The Bund, Dongchangzhi Road
Brand	W
Operator	Starwood
No. of buildings	1
No. of rooms	383
Transport links	35 minutes' drive to Hongqiao Airport 55 minutes' drive to Pudong International Airport 1 minute walk to the nearest metro station (International Cruise Terminal station, line 12)
Handover date	Q1/2017

Source: Savills Research

Please contact us for further information

Savills Research



James Macdonald
Director, China
+8621 6391 6688
james.macdonald@savills.com.cn

Savills Hotels



Nathalia J. Wilson
Senior Director, Asia Pacific
+65 6415 7589
nwilson@savills.com.sg



Annie Wang
Director, China Beijing
+8610 5925 2029
annie.wang@savills.com.cn



Angel C Chen
Associate Director, China
+8621 6391 6688*842
angelc.chen@savills.com.cn

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