

Briefing Hotel sector

November 2016



Image: Atour Hotel, Chengdu

SUMMARY

Despite rising occupancy rates, hotel operators continue to reduce ADRs in a wide range of markets.

- Five-star hotel average daily rates (ADRs) fell across all city tiers in Q2/2016, according to government data.
- Occupancy rates continued to trend up, with five-star hotels in first-tier cities reaching highs last seen in December 2011. Second- and third-tier cities continue to show a more moderate recovery.
- The rise of China's middle class is expected to result in increased demand for hotels, especially the three- to four-star segment.
- Increased domestic travel, especially for short weekend getaways, saw some third-tier cities record higher occupancy rates in the three-star market than those seen in first-tier cities.

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 “Although the hotel market is faced with oversupply issues in cities nationwide, the growth of domestic tourism has seen market performance improve, particularly in the three-star hotel segment.” James Macdonald, Savills Research

→ **China-wide hotel market overview**

Many cities in China are faced with an oversupply in hotels, resulting in lacklustre occupancy rates. However, with the market evolving from a business traveller-focused one to more of a domestic leisure traveller, hotels have adjusted their ADRs down to appeal more to the local demographic, which has in turn seen occupancy rates recover.

The rise of three-star hotels in China is a direct correlation to continual increases in domestic tourism numbers, further highlighting the shift from business travellers and tour groups to more solo and family leisure travellers.

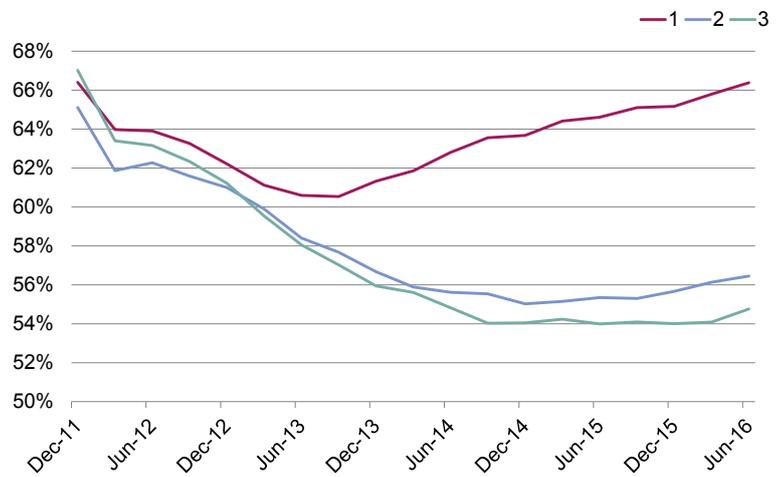
Five-star hotel occupancy rates in first-tier cities continued on their upward trend, increasing 2.4 percentage points (ppts) year-on-year (YoY) to 68.5%. Shanghai performed particularly well, with occupancy rates at 72.9%, the highest seen in the last five years.

Although second- and third-tier cities are still way below the peaks seen in Q4/2011, they are showing signs of a slow recovery, up 1.3 ppts to 58.5% and 2.7 ppts to 55.1% respectively. Second-tier cities that showed stronger growth were Zhengzhou, Xi'an and Tianjin, which all experienced approximately 8 to 15 ppts growth YoY.

First-tier cities have seen a decrease in five-star ADRs after remaining largely stable for the last two years, down 5.4% YoY to RMB815.8 per night. Meanwhile, second- and third-tier cities saw their declines of the previous two years continue and accelerate, falling 9.3% YoY to RMB537.5 per night and 7.8% YoY to RMB521.5 per night respectively. The only two second-tier cities to record YoY increases were Nanjing and Wuhan, up 8.4% and 1.9% respectively; however, they were also two of the lower performing second-tier cities in terms of occupancy rates.

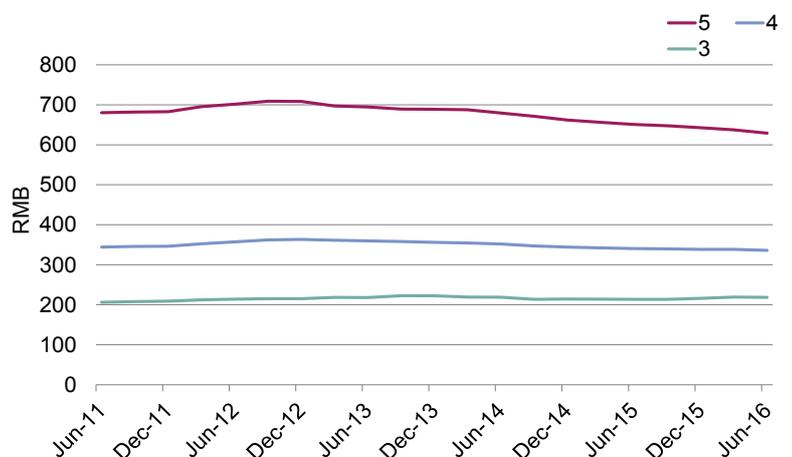
The three-star market is performing relatively well, specifically in first-tier cities where ADRs reached RMB335.6 per night (up 2.7% YoY). Occupancy

GRAPH 1 **Five-star occupancy rates by tier city (4QMA*), Dec 2011–Jun 2016**



Source: China National Tourism Administration; Savills Research
 *4QMA: four quarter moving average, which eliminates seasonal and accidental effects and shows the overall trend. The figure is based on the average four-quarterly turnover over a period which each time shifts 1 quarter.

GRAPH 2 **Five-star ADR by tier city (4QMA), Dec 2011–Jun 2016**



Source: China National Tourism Administration; Savills Research

rates in this market remained relatively stable, though slightly down YoY, resulting in an increase in RevPAR YoY.

Domestic tourism is sitting at approximately 3.8 billion person times (2015), an 11% YoY growth. A large portion of this market is middle class with a growing disposable income, an increasing percentage of which is dedicated to travel. A correlation can be drawn between this and the improvement of the three-star market. Shanghai remains head and shoulders

above the other members of the ten largest five-star hotel markets. It has the highest ADR and occupancy rates, giving it a RevPAR of RMB708 per night compared with Beijing, ranked second, at RMB553 per night.

The third and fourth largest five-star hotel markets, Wuxi (27 hotels) and Chongqing (26 hotels), continue to underperform, predominantly due to oversupply. Wuxi had the lowest occupancy rate of the ten largest markets at 55%, resulting in a RevPAR of RMB290 per night, with

→ Chongqing even lower at RMB275 per night.

The two smallest markets in the top ten, Nanjing (20) and Xiamen (19) both saw higher occupancy rates, matching those seen in Beijing, of 69%.

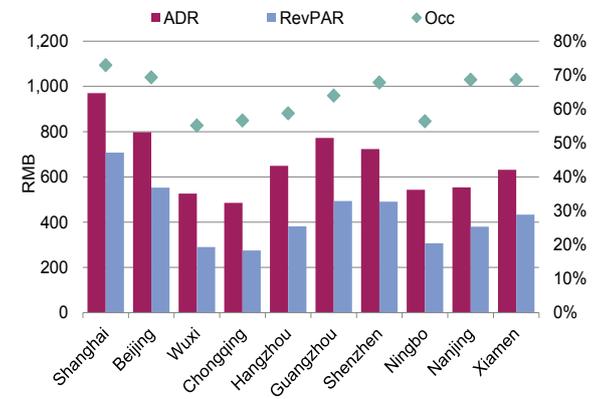
The rise of the three-star hotel market in China

While a lot of developers have historically focused on the development of five-star hotels in the hope of capturing overseas tourists and wealthy business travellers, the real opportunities are emerging in the three- four-star markets that target

the emerging middle class. There are many different estimates on the size of the middle class, depending upon what the analysts' definition of middle class is, but all analysts agree that the number is increasing, and it is doing so rapidly. The Economist Intelligence Unit estimated in 2016 that the proportion of the population making more than US\$10,000 per annum would increase from 10% in 2015 to 35% in 2030. With these higher incomes, spending on leisure, entrainment and travel is expected to increase significantly.

China has seen a steady increase in domestic tourism over the last

GRAPH 3 Ten largest five-star markets key metrics, Q2/2016



Source: China National Tourism Administration; Savills Research

TABLE 1 China hotel key metrics by star rating

	ADR (RMB)			Occupancy rate			RevPAR (RMB)		
	16Q2	YoY	Vs 3 yr ave	16Q2	YoY	Vs 3 yr ave	16Q2	YoY	Vs 3 yr ave
5 star	612	-5.2%	-6.7%	59.4%	2.4 ppts	2.9 ppts	363	-1.2%	-4.1%
4 star	328	-3.1%	-4.0%	56.6%	1.0 ppts	0.9 ppts	186	-1.4%	-3.8%
3 star	207	-1.5%	-1.5%	52.8%	-0.3 ppts	-1.4 ppts	109	-2.1%	-4.2%

Source: China National Tourism Administration; Savills Research

TABLE 2 China five-star hotel key metrics by city tier

	ADR (RMB)			Occupancy rate			RevPAR (RMB)		
	16Q2	YoY	Vs 3 yr ave	16Q2	YoY	Vs 3 yr ave	16Q2	YoY	Vs 3 yr ave
1st tier	815.8	-5.4%	-6.3%	68.5%	2.4 ppts	4.2 ppts	561.2	-1.7%	0.1%
2nd tier	537.5	-9.3%	-13.5%	58.5%	1.3 ppts	1.5 ppts	316.3	-6.9%	-10.6%
3rd tier	521.5	-7.8%	-14.9%	55.1%	2.7 ppts	1.0 ppts	289.0	-3.6%	-14.1%

Source: China National Tourism Administration; Savills Research

TABLE 3 China four-star hotel key metrics by city tier

	ADR (RMB)			Occupancy rate			RevPAR (RMB)		
	16Q2	YoY	Vs 3 yr ave	16Q2	YoY	Vs 3 yr ave	16Q2	YoY	Vs 3 yr ave
1st tier	473.8	-0.8%	-1.2%	66.9%	-0.1 ppts	2.2 ppts	317.9	-0.8%	2.3%
2nd tier	336.7	-3.6%	-6.4%	60.8%	1.2 ppts	1.0 ppts	205.2	-1.8%	-4.7%
3rd tier	314.0	-3.7%	-5.9%	55.4%	0.9 ppts	-0.7 ppts	175.4	-1.7%	-6.7%

Source: China National Tourism Administration; Savills Research

decade, recording a compound annual growth rate of 13.1%. Government figures indicate that domestic tourism had increased to over 3.8 billion person times by 2015.

Three star hotel occupancy rates in first-tier cities were still below four- and five-star hotels in Q2/2016, by 6.1 and 7.7 ppts respectively. However, the difference is much less in second- and third-tier cities: in third tier cities, three-star hotel occupancy rates are only 1.0 ppt lower than four-star hotels, and 0.7 of a ppt lower than five-star. A number of third-tier cities, such as Kunming and Fuzhou, recorded even higher occupancy rates (76.2% and 65.2% respectively) than the first-tier cities, where Shenzhen had the highest recorded occupancy rate of 65.1%.

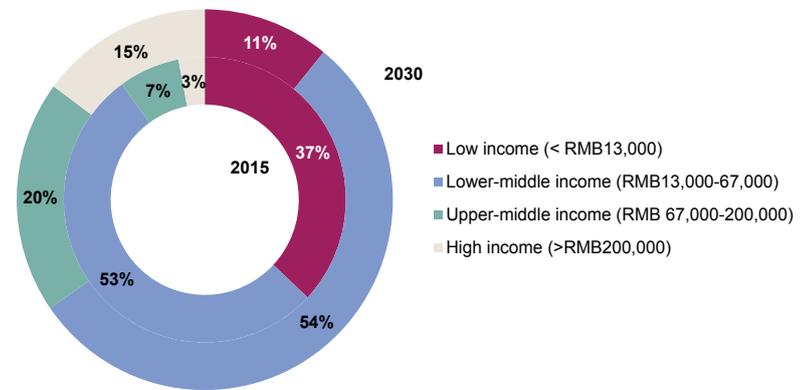
The rise in the middle class population, combined with the continued development of infrastructure networks (plane and train) and car ownership, has also resulted in a marked increase in weekend leisure trips with family and/or friends as more city workers require the occasional break from the hectic lifestyles of city living in the fastest growing large economy.

China-wide, three-star hotel ADRs remained relatively stable in the 12 months to Q2/2016, with rates falling by just 1.5% YoY to RMB207 per night; during the same period, five-star ADRs fell by 5.2% while four-star ADRs fell by 3.1%.

Shanghai recorded a phenomenal quarter, which could be attributed to the launch of the Shanghai Disney Resort. Three-star hotel ADRs increased 7.3% YoY to RMB364 per night, while occupancy rates ranged from 72.9% (five-star) to 63.8% (three-star). Since opening, the Shanghai Disney Resort has averaged roughly 20,000 visitors per day; about 40% of visitors were expected to be from Shanghai and nearby cities, while the rest are from further away, requiring accommodation during their trip.

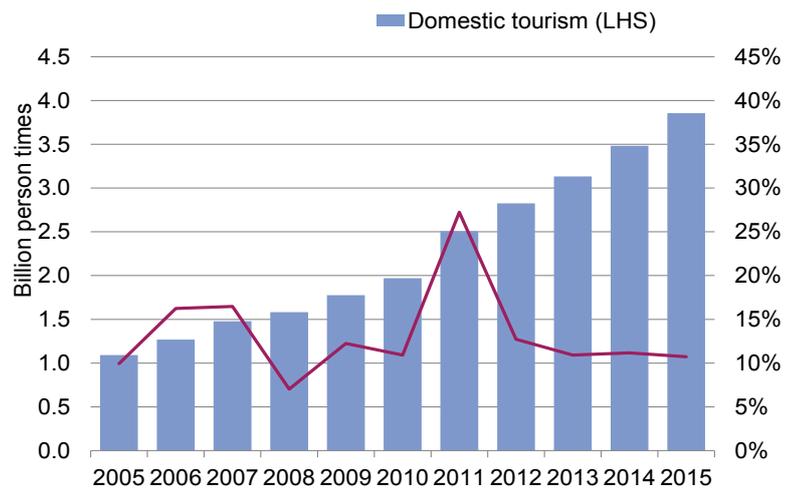
More consumers, particularly millennials, are turning to social media, travel websites or mobile apps

GRAPH 4 Disposable income levels, 2015 vs 2030



Source: Savills Research

GRAPH 5 Domestic tourism in China, 2005–2015



Source: China National Tourism Administration; Savills Research

such as Ctrip, Mafengwo or Qunar to research and then book holiday accommodation. Guests increasingly read peer reviews on hotels and search for the best value for money accommodation package to suit their needs – and in terms of domestic travel this will often result in them booking rooms in established Chinese three-star hotels.

Oversupply and the anti-corruption campaigns have resulted in hotel developers in China no longer being in a position to offer expensive services, such as a range of in-house restaurants and bars or a variety of entertainment. This has seen increased development in limited

service hotels in the three- and four-star sector, with a focus on simplifying services and lowering operational costs. This could include a combined reception and concierge desk, or incorporating only one in-house F&B venue.

Market News

Shanghai Disney Resort launches
The Shanghai Disney Resort opened on 16 June 2016, and is expected to attract over 15 million visitors each year. Encompassing Shanghai Disneyland Park, an entertainment district, two themed hotels (420 rooms and 800 rooms), parking lots and transportation links, the park is almost 4 sq km in total. Additional phases will

see the development of two additional parks at the resort.

China Life invests in Starwood Capital Hotels

Chinese insurance company, China Life, has purchased a stake in Starwood Capital Group valued at US\$2 billion. Now a lead investor in the select service hotel portfolio of 280 properties spanning 40 states in the US, China Life has a sizeable platform for future investments in the US hotel market.

Choice Hotels partner with Ctrip
One of the largest hotel companies in the world, Choice Hotels, signed

a global agreement with Ctrip, the largest online travel agency in China. In anticipation of Chinese outbound tourism being the largest market for the US by 2019, Choice Hotels has added a series of new amenities, including Chinese-oriented service offerings and accepting Union Pay in participating Comfort Inn and Comfort Suites brands. Choice Hotels expects the partnership to deliver more bookings, further growing their reach into the Chinese market.

Market outlook

There has been a growing trend of seeing hotels purchased with the plan to be converted to offices or

even co-living communities. Not only can this be challenging in terms of design and construction, it is also not expected to make a significant dent in the oversupply seen in many hotel markets.

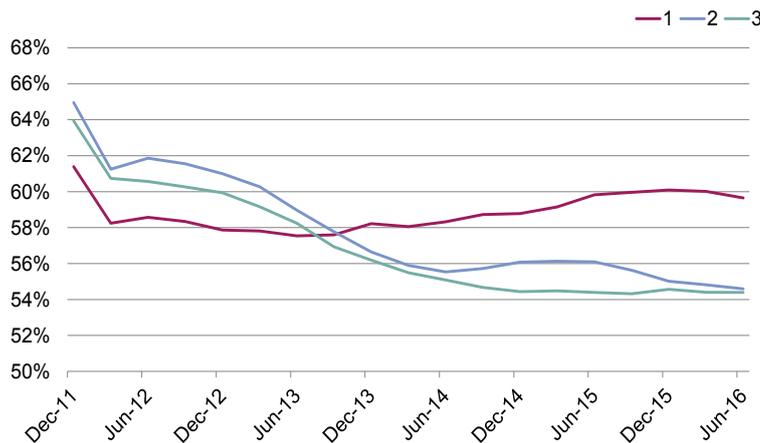
The completion of the Shanghai Disneyland Resort is a positive development for the city's hotel sector, however, hotels will need to ensure their service offering is adapted from the usual business traveller needs to be more family-friendly.

Following on from this, the increase in middle class travel, combined with the second-child policy, could see an increase in the need for more family-oriented hotels and child-friendly service offerings. Parents are more likely to book their next vacation in a hotel which has a family-sized room available, offers a babysitting service and has children's play areas.

2016 saw rising occupancy rates from falling ADRs as operators worked to improve performance. The continuous growth in demand from domestic tourism and business travellers has seen improving performance in terms of occupancy rates, particularly in first-tier cities like Shanghai with the launch of the Disney Resort. In light of growing demand supported by the further development of tourism infrastructure and facilities, domestic developers previously very reliant on international operators managing their properties are moving towards building their own brands which cater directly to the local market, enabling developers to maximise profitability in a sector previously overlooked.

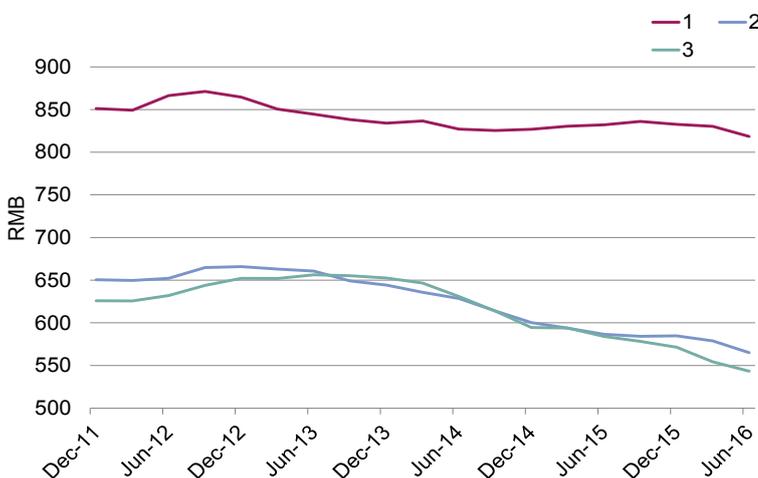
The steady growth in occupancy rates over the last three years is expected to continue in 2017, supported by the on-going trend of increased domestic travel. This could see operators slowly start to increase ADRs again, particularly in first-tier cities with five-star hotels expected to increase by approximately 2% YoY to an average of RMB625 nationwide while occupancy rates are expected to increase approximately 2.8 ppts YoY to a nationwide average of 65%. ■

GRAPH 6
4QMA three-star occupancy rates by tier city, Dec 2011–Jun 2016



Source: China National Tourism Administration; Savills Research

GRAPH 7
4QMA star-rated ADR, Jun 2011–Jun 2016



Source: China National Tourism Administration; Savills Research

Project focus

MiniMax Xiamen Central

The MiniMax Xiamen Central consists of 74 rooms, including 42 duplex rooms, and is located in the Shimao Hubin residential project, less than 10km away from the Xiamen Gaoqi Airport. The hotel incorporates local traditional elements into the innovative, community-oriented design that exemplifies the MiniMax brand. Launched in December 2016, standard guest rooms start from RMB400 and duplex rooms from RMB600.

Location	Huli District, Xiamen
Brand	MiniMax
Operator	Shimao
No. of rooms	74
Transport links	9.3km from Xiamen Gaoqi Airport
Handover date	December 2016
Nightly rates starting from	RMB400 – 600 excluding service charges



Source: Savills Research

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