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Savills World Research
China

Briefing
Hotel sector

February 2017

Image: Capella Villa, Shanghai (Source: Jacques Gavard)

SUMMARY

Nationwide ADRs fall further as operators continue to prioritise occupancy rates.

- Five-star hotel average daily rates (ADRs) continued to fall across all city tiers in Q4/2016, according to government data.
- Five-star hotel occupancy rates in first-, second- and third-tier cities continued to increase on a year-on-year (YoY) basis. First-tier cities saw the most robust growth, reaching a six-year high.
- The three- and four-star hotel markets continued to see rising demand from domestic travellers especially in first- and select second-tier markets.
- The rise of home-sharing platforms and serviced apartment operators will put pressure on hotels, especially those catering to business travellers.
- Underperforming hotel assets in first-tier cities remain targets for niche investors looking to convert projects into residential or office units for higher returns.

"The performance of three-star hotels particularly in first-tier cities continues to diverge from that of the market as a whole, driven primarily by demand generated from local travellers."

James Macdonald, Savills Research

China-wide hotel market overview

China's hotel market continues to suffer from a supply glut caused by over-exuberant construction in recent years. Despite the ongoing development of the domestic-tourism industry, the decline of inbound-tourism numbers combined with intensifying competition among existing projects and home-sharing platforms such as Airbnb and Tujia have forced operators to sacrifice ADRs in order to achieve higher occupancy levels.

Discrepancies clearly remain between different city tiers and star-ratings; however, overall the market continued to witness a downward trend. The three-star hotel market remains one of the better performers, witnessing increasing demand from domestic budget business and leisure travellers, particularly in first-tier cities. At the same time, these hotels continue to attract the attention of investors seeking to convert them into offices and residential units, decreasing stock.

Driven by growing demand for the domestic high-end hotel market, five-star hotel occupancy rates further strengthened across first-, second- and third-tier cities in the latter half of 2016.

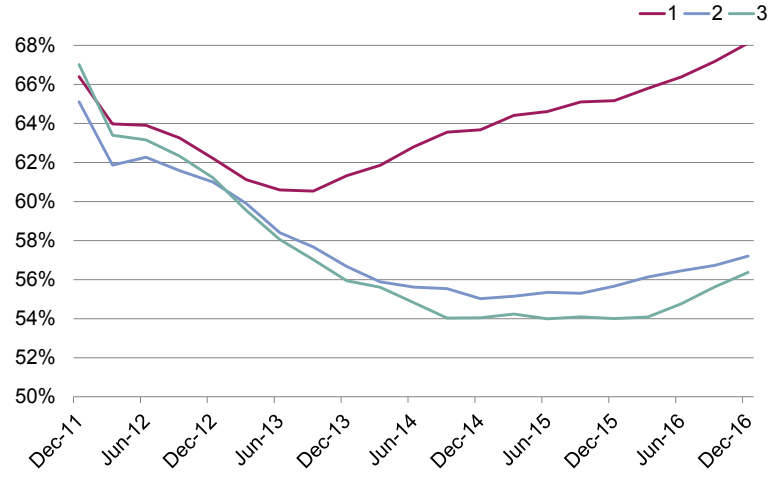
Occupancy rates in first-tier cities recorded the most robust growth, averaging 71.6% in Q4/2016, an increase of 3.8 percentage points (ppts) year-on-year (YoY). Shenzhen achieved the highest occupancy rate at 75.0%, increasing by 2.5 ppts YoY, while Shanghai saw the greatest improvement of occupancy levels by 6.4 ppts YoY, to place second among first-tier cities at 74.3%.

Second- and third-tier cities continued to trend upwards in Q4/2016, although levels generally remain lower than those of first-tier markets. Second-tier cities continued to show signs of a sluggish recovery, increasing by just 1.9 ppts YoY to 59.6%. By comparison, rates in third-tier cities rose by 3.0 ppts over the same period, although occupancy levels remain slightly lower at 58.7%.

Chongqing and Qingdao recorded the strongest growth among second-tier cities, increasing by 7.6 and 7.2 ppts YoY during the period, respectively.

GRAPH 1

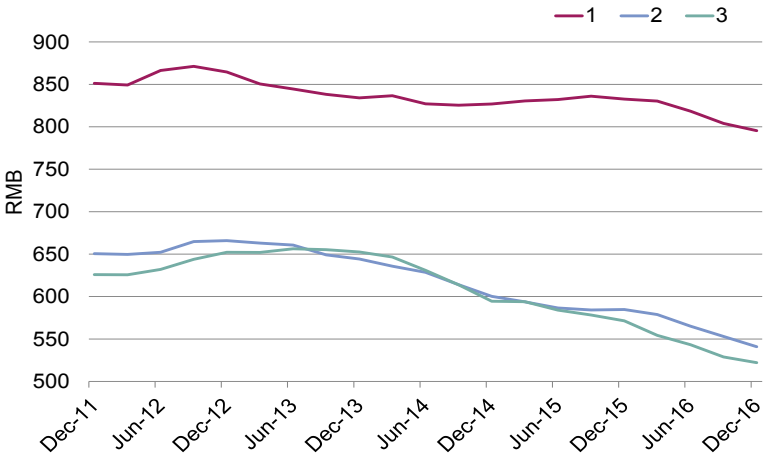
Five-star occupancy rates by tier city (4QMA*), Dec 2011–Dec 2016



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 one quarter.

GRAPH 2

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



Source: China National Tourism Administration; Savills Research

Faced with intense competition, many hotel operators continue to favour a strategy of lowering rates to attract hotel guests in order to increase occupancy levels. As a result, ADRs continued to decline across nearly all city-tiers and hotel types.

Five-star hotel ADRs continued to decline on a yearly basis in Q4/2016, falling a further 4.1% in first-tier cities to RMB816.2 per room night. Second-tier cities saw the sharpest decline of 8.3% YoY to RMB534.7 per sq m per room night. Of the 16 second-tier cities tracked, only Hangzhou (9.4%), Shenyang (7.8%) and Wuxi (5.5%) posted YoY increases. However, the particularly high growth rates in Hangzhou and Shenyang likely contributed to a decrease in city-wide occupancy levels, which fell by 1.7 and 3.8 ppts, respectively, during the same period. Third-tier city ADRs declined by 4.9% YoY to RMB514.6 per room night.

The three-star hotel market in first-tier cities remained one of the few where

ADRs increased in Q4/2016, up 3.0% YoY to RMB 351.1 per room night. Occupancy rates of this segment also rose slightly by 0.2 of a ppt YoY, causing revenue per avalible room (RevPar)to rise by 3.4% on a yearly basis.

Having achieved the highest ADR and occupancy rates, Shanghai reached an average RevPar of RMB705 per room night, compared to RMB549 per room night in second place Beijing.

Despite achieving the lowest occupancy level at 58%, five-star hotels in Hangzhou continued to achieve relatively high ADRs for a second-tier city as RevPar reached RMB410 per room night. By contrast, Chongqing and Wuxi continued to record the lowest RevPar at RMB299 and RMB341 per room night.

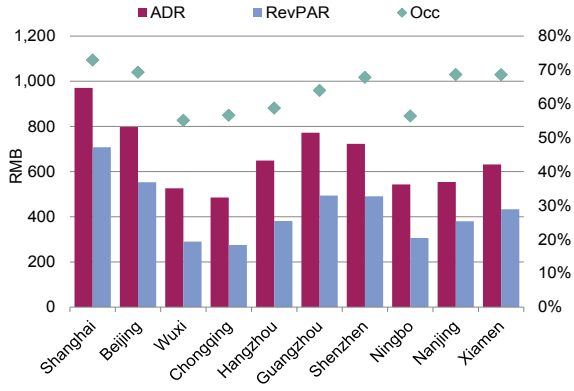
Shanghai and Nanjing saw the two highest occupancy rates among the ten largest markets, at 74% and 72%, respectively.

Superior margins encourage three-star hotel investment

While the three- and four-star hotel markets have traditionally taken a back seat to the development of luxury brands, the government's ongoing anti-graft campaign

GRAPH 3

Ten largest five-star markets key metrics, Q4/2016



Source: China National Tourism Administration; Savills Research

TABLE 1

China hotel key metrics by star rating

	ADR (RMB)			Occupancy rate			RevPAR (RMB)		
	16Q4	YoY	Vs 3 yr ave	16Q4	YoY	Vs 3 yr ave	16Q4	YoY	Vs 3 yr ave
5 star	615.0	-3.8%	-5.3%	62%	3.0 ppts	3.4 ppts	378.6	1.1%	-2.1%
4 star	334.7	-2.1%	-2.7%	59%	1.6 ppts	1.0 ppts	195.8	0.6%	-2.3%
3 star	218.6	-6.7%	-5.0%	54%	-0.2 ppts	-1.2 ppts	117.1	-7.1%	-5.8%

Source: China National Tourism Administration; Savills Research

TABLE 2

China five-star hotel key metrics by city tier

	ADR (RMB)			Occupancy rate			RevPAR (RMB)		
	16Q4	YoY	Vs 3 yr ave	16Q4	YoY	Vs 3 yr ave	16Q4	YoY	Vs 3 yr ave
1st tier	816.2	-4.1%	-4.9%	71.6	3.8 ppts	4.1 ppts	584.8	1.5%	1.1%
2nd tier	534.7	-8.3%	-10.9%	59.6%	1.9 ppts	2.2 ppts	320.7	-4.8%	-7.1%
3rd tier	514.6	-4.9%	-12.0%	58.7%	3.0 ppts	2.8 ppts	307.2	1.5%	-6.8%

Source: China National Tourism Administration; Savills Research

TABLE 3

China four-star hotel key metrics by city tier

	ADR (RMB)			Occupancy rate			RevPAR (RMB)		
	16Q4	YoY	Vs 3 yr ave	16Q4	YoY	Vs 3 yr ave	16Q4	YoY	Vs 3 yr ave
1st tier	468.4	-0.5%	-1.3%	70.7%	2.8 ppts	3.2 ppts	330.6	3.5%	3.2%
2nd tier	337.8	-6.5%	-8.2%	61.9%	2.3 ppts	1.2 ppts	210.2	-2.7%	-6.2%
3rd tier	318.8	-5.1%	-5.4%	59.1%	1.2 ppts	0.2 ppts	190.6	-2.0%	-4.3%

Source: China National Tourism Administration; Savills Research

combined with rising disposable incomes of the burgeoning middle class have seen investment into the mid- and mid-to-high hotel market increase in recent years. Appealing to customers who want to enjoy some of the amenities of a five-star hotel but do not want to pay the higher costs associated with luxury brands, three- and four-star hotel operators are able to charge competitive rates while greatly reducing operating expenses by eliminating some of the services provided by their five-star counterparts entirely. The higher margins resulting from this business model have fuelled active expansions by many three- and four-star hotel brands most notably in cities with large tourism and exhibition industries.

According to China's National Tourism Administration, the domestic travel market increased by 11% YoY in 2016 to 4.28 person times. Annual tourism revenues reached RMB3.9 trillion during the same period, up 14% YoY.

The domestic tourism industry's recent boom can be attributed to a number of factors tied to the growth of China's urban middle-class population. Rising incomes have allowed people to afford increasing leisure spending on trips and holidays with friends and families. Moreover, ongoing infrastructure development (airports and railways) as well as expanding car ownership have made long-distance travel easier and more affordable.

Differences do remain between domestic and international travellers, which manifest themselves in hotel choice. A larger proportion of international tourists demonstrate a stronger desire for a more luxurious experience given by four- and five-star rated international operators. By contrast, many domestic travellers seek budget opportunities, using travel websites and mobile apps such a Ctrip, Mafengwo and Qunar to find and book more affordable package deals typically offered by domestic three-star hotels, causing an uptick in demand for this type of accommodation.

Growing demand for three-star hotels, especially in first-tier markets, helped stabilise occupancy rates, which

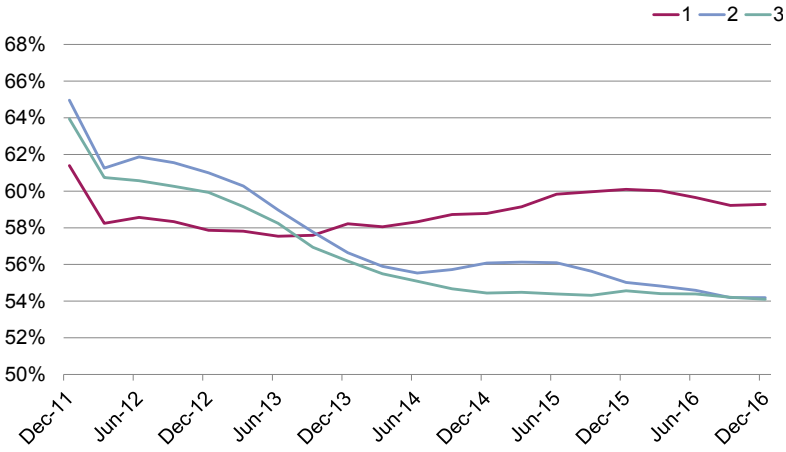
GRAPH 4

Domestic tourism in China, 2005–2016

Source: China National Tourism Administration; Savills Research

GRAPH 5

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



Source: China National Tourism Administration; Savills Research

decreased by just 0.2 ppts YoY in Q4/2016. However, despite the strong individual market performances, three-star ADRs in China fell by 6.7 ppts YoY to RMB129 per room night. By comparison, nationwide five- and four-star hotel ADRs decreased by 3.8% and 2.1%, respectively, over the same period.

Shanghai's three-star hotel market has continued to benefit from the growth in tourism numbers attributed to the opening of Shanghai Disney Resort in June 2016 with occupancy levels rising by 1.4 ppts to 62.4%. On the back of this increasing demand, operators had the confidence to raise ADRs, which increased by 11.3% YoY in Q4/2016 approximately 7.0% higher than second-place Shenzhen. The robust ADR growth witnessed by Shanghai helped underpin the increase seen by the first-tier city three-star hotel market, which rose by 3.0% YoY.

Compared to first-tier cities, the gap between three-star hotels and four- and five-star hotels remains much closer in second- and third-tier markets. Occupancy rates of three-star hotels in first-tier cities remain approximately 9.0 and 10.0

percentage points (ppts) behind those of four- and five-star hotels, respectively, at 62%. By contrast, three-star hotels in second-tier cities stood 4.0 and 6.0 ppts behind, while the difference was even smaller in third-tier markets (2.0 ppts from both four- and five-star rated hotels). The larger discrepancy in first-tier cities suggests that these market's three-star hotel occupancy rates still have greater room to improve. Data from the previous quarter appeared to confirm this as three-star hotel occupancy rose on a YoY basis in first-tier cities in Q4/2016, while they remained flat in second-tier cities and decreased in third-tier cities.

Market News

Home-sharing competition heats up as China Investment Corp. commits $100 million to Airbnb

Home-sharing platforms such as Airbnb have not made the same splash in China as they have in other international markets. However, this may change following the investment of USD$100 million by one of the country's sovereign wealth funds, China Investment Corp., into the San Francisco-based start-up. While Airbnb has made inroads into the Chinese market, their expansion has to date been relatively cautious compared to other international companies such as Uber, which rushed headlong into the mainland market only to be ousted by Chinese competitor Didi last year. However, Airbnb's strategy may be too little too late as its share of the local market is small at just 80,000 listings compared to its local rival Tujia which currently has more than 400,000 listings in addition to a further 300,000 on its low-cost platform Mayi. Tujia has also recently launched its own funding round, planning to raise US$300 million to capture an even-larger market share.

Shimao partners with Starwood Capital to create new Chinese joint venture

One of China's largest developers, Shimao Property Holdings, has announced plans to launch a hotel joint venture in China with leading international private investment company Starwood Capital Group. The venture, which will be owned 51% by Shimao and 49% by Starwood, looks to build upon Shimao's existing stock of mid- to mid-high-end hotels using the operational and financial expertise of Starwood, which manages one of the world's largest global hospitality portfolios. The move by Starwood highlights the continued potential of the domestic hotel market, which despite talks of oversupply still has room to grow, in particular amongst non-luxury consumers as the focus of development until this point has been disproportionally focused on five-star products.

Market outlook

Occupancy rates took precedent in 2016 for operators who looked to cut rates in order to boost their hotel's performances, causing ADRs to trend down over the past 12 months. With many prime projects in key tourist locations now reporting full or near-full occupancy levels, some operators, particularly in first-tier cities, may now have enough confidence to adjust rates accordingly in the coming years, especially as demand from domestic travellers continues to increase.

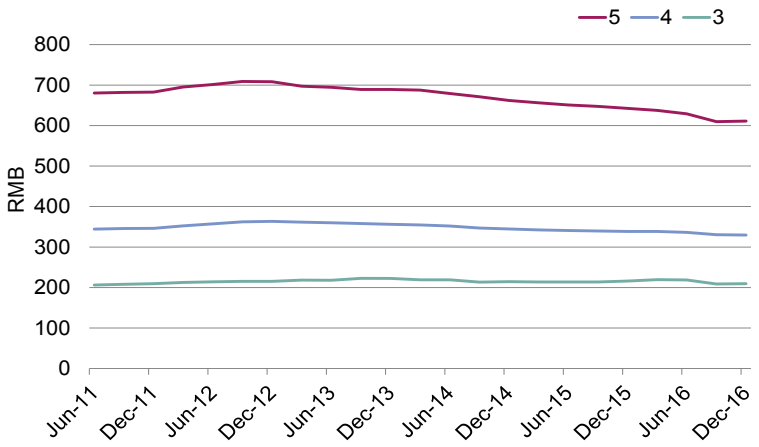
The expected growth of the domestic tourism industry will further influence the development of China's hotel market. The rise in disposable income per capita will continue to generate new demand as an increasing number of people have the financial means to travel for leisure and holiday. Sub-luxury hotels offering discounted rates or packages as well as family-friendly venues will expect to see the largest growth in the next several years.

Foreign hotel brands remain bullish on the China market and will increasingly look for partnerships with local players with existing stock to expand their brands or create new hotel concepts catering specifically to local customers. Many of these new concepts will not focus on the ultra-luxury market due to existing oversupply, but on mid- and mid-high end segments where demand is growing the fastest.

Given the development of the local hotel industry, many domestic hotel developers who have been historically reliant on international operators to manage their properties have begun to build out their own brands targeting local travellers. At the same time, a growing number of Chinese-owned and -operated luxury hotels have emerged to compete in a market traditionally dominated by large international players. Many Chinese budget hotels such as the 7 Days Inn, Jin Jiang Hotel and GreenTree Inns have also announced plans for international expansions, citing the need for Chinese-operated hotels to accommodate the ongoing growth of outbound tourism and business travel.

GRAPH 6

China ADR by star rating (4QMA), Jun 2011–Dec 2016



Source: China National Tourism Administration; Savills Research

Project focus

Capella Shanghai, Jian Ye Li

Capella's Jian Ye Li hotel will become Shanghai's only townhouse hotel when it opens in Q2/2017. Located in a historical preservation zone of the city's Xuhui district, the Jian Ye Li includes 55 historical "shikumen" villas (traditional Shanghainese architecture combining both Chinese and Western influences) outfitted with ultra-luxury amenities and services. The project will also comprise 40 luxury serviced apartments. In addition to a central location in the heart of Shanghai's cultural hub, guests and residents of the Jian Ye Li will be able to enjoy a French brasserie, an award-winning Auriga Spa, as well as Pierre Gagnaire, a three-star Michelin Restaurant. Standard villa rates begin at RMB5,000 per night, while the serviced apartments start at RMB130,000 per month.

Location	Xuhui District, Shanghai
Brand	Capella
Operator	Capella Hotel Group
No. of rooms	55 "shikumen" villas; 40 luxury residences
Transport links	45.5km from Pudong International Airport (PVG); 13km from Hongqiao Airport (SHA)
Handover date	July 2017
Nightly rates starting from	RMB5,000 per night for villas; RMB130,000 per month for serviced apartments

Image: Entrance to "Shikumen" villa (Source: Jacques Gavard)

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