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Savills World Research
China

Briefing
Hotel sector

July 2018

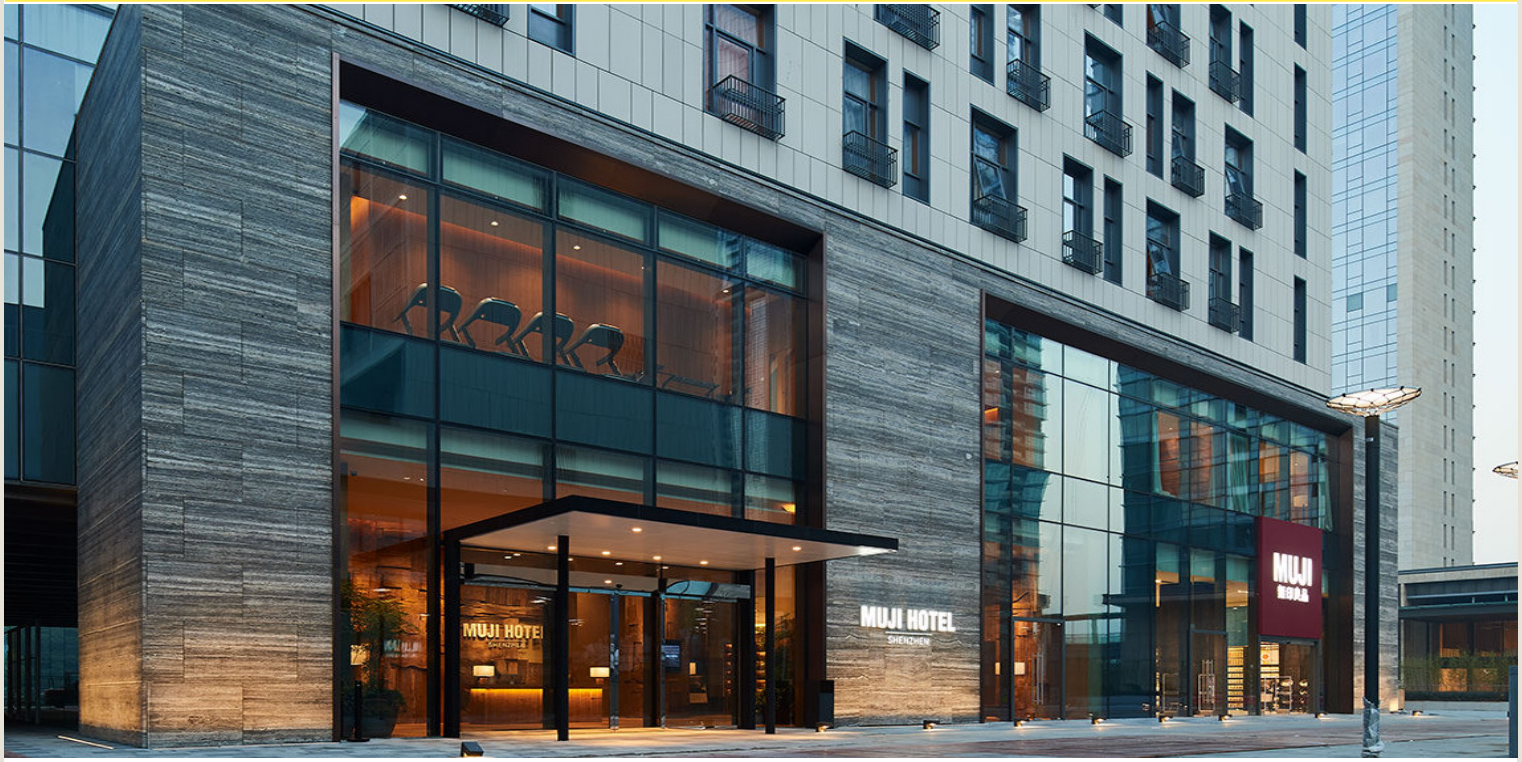


Image: Muji Hotel (Ryohin Keikaku Co.)

SUMMARY

A continued pick up in first tier city occupancy rates has encouraged operators to gradually increase ADRs leading to renewed growth in RevPAR and reigniting investor interest.

- First tier city five-star hotel average daily rates (ADRs) have all increased year-on-year (YoY) in Q4/2017, with growth in Beijing of 8.8% Shanghai of 4%, Guangzhou of 6%, and Shenzhen of 8.7%.
- Occupancy rates in first, second and third tier cities registered at 69.7% (up 1.6 ppts YoY), 61.4% (up 4.2 ppts YoY) and 58.1% (up 1.7 ppts YoY), respectively.
- Revenue per Available Room (RevPAR) in first-tier cities stood at RMB575.4, while in second-tier cities at RMB336.2, and third-tier cities at RMB300.8 by Q4/2017.
- Most popular destinations for domestic travel included Jiangsu (13%), Guangdong (11%), and Shanghai (10%).

"Landlords are looking to actively manage asset portfolios, make more effective use of dead spaces while generating new income streams. They are also increasingly engaging with asset managers and customising and updating offerings to meet the needs of a new generation of travellers." James Macdonald, Savills Research

China-wide five star hotel market overview

First tier city ADRs increased to RMB823.6 on a Four Quarter Moving Average (4QMA) basis by the end of 2017, which represented a 3.5% increase YoY. ADRs for second and third tier cities both trended downward to RMB542.9 (down 0.4% YoY) and RMB510.6 (down 2.2% YoY), respectively.

Five star occupancy rates

Occupancy rates increased for all three tiers of cities in 2017, with first, second and third tier cities registering on a 4QMA basis at 69.7%, 61.4% and 58.1%, respectively. Occupancy rates have been steadily rising in first tier cities since Q4/2013 while second and third tier cities only saw a turnaround in Q4/2015. Second tier cities saw an especially strong improvement towards the end of 2017, as a result of limited hotel supply, rising domestic business travel and improving infrastructure and service quality.

Five star revenue per available room

First tier cities saw five star RevPAR rise on a on a 4QMA basis to RMB575.4 in Q4/2017, up 7.1% YoY, while second and third tier city RevPAR increased 3.9% YoY and fell 4.1% respectively on a 4QMA basis.

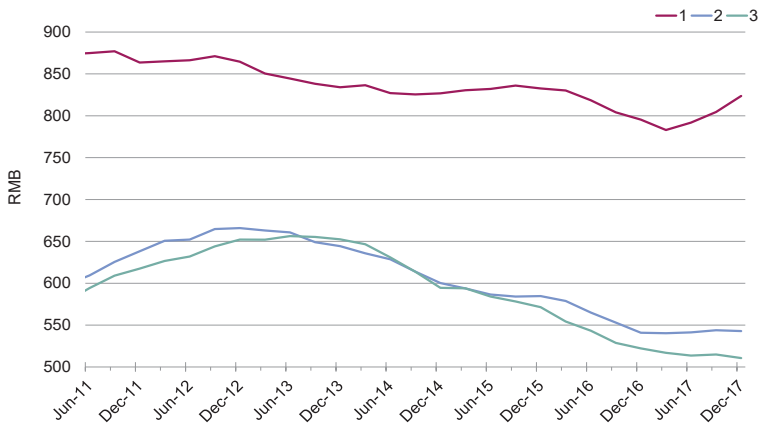
Several cities across China experienced positive RevPAR growth in 2017, but the most dramatic YoY increases occurred in Suzhou (33.3%), Guangzhou (32.5%), and Tianjin (22.2%); the worst RevPAR performers in 2017 were Wuxi (-17.1%), Ningbo (-6.8%) and Dalian (-6.3%).

Shanghai (RMB994) and Guangzhou (RMB965) achieved the highest ADRs out of the fifty cities tracked by CNTA, as well as Sanya (RMB939), a popular tourist destination. The lowest ADRs achieved by second tier cities were in Shenyang (RMB374) and Zhengzhou (RMB256).

Sanya however achieved the highest occupancy rates of any city covered by CNTA, standing at 79.3% by the end of year (averaging 73.1% over the last four quarters) this was followed by Zhengzhou (77.5%), Shenzhen

GRAPH 1

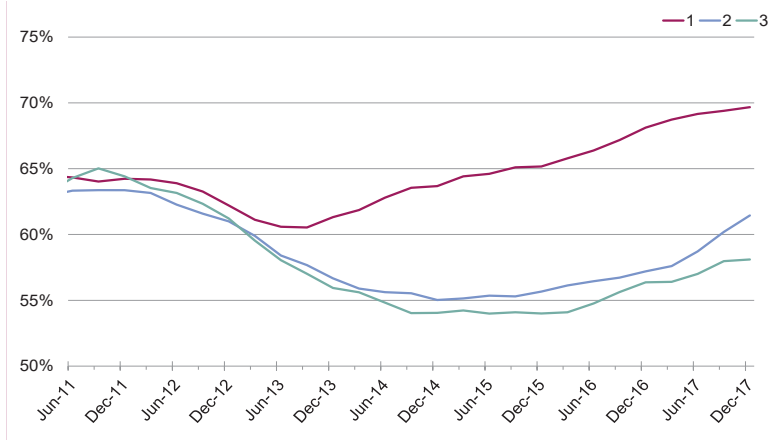
Average daily rates by tier city (4QMA*)



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

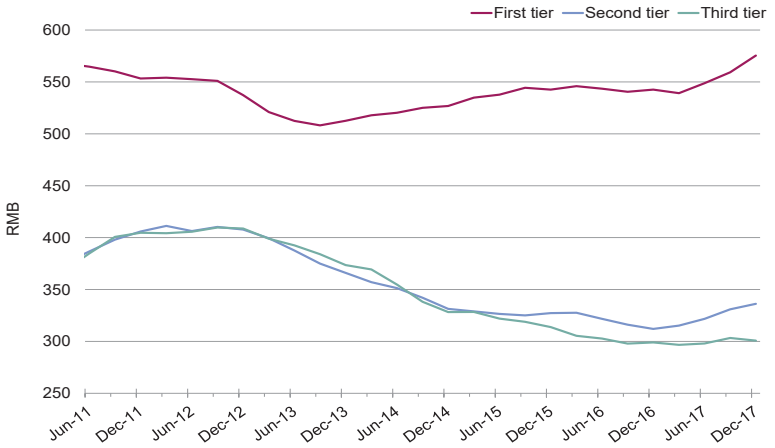
Occupancy rates by tier city (4QMA)



Source: China National Tourism Administration; Savills Research

GRAPH 3

Revenue per available room by city tier (4QMA)



Source: China National Tourism Administration; Savills Research

(75.3%) and Guangzhou (75.1%). RevPAR reflected similar positioning—the highest RevPAR were Sanya (RMB744), Guangzhou (RMB725) and Shanghai (RMB723), and the lowest values of any second tier city were Shenyang (RMB226) and Zhengzhou (RMB199).

Sanya, despite not being a first or second tier Chinese city and only home to roughly 550,000 people is an important tourist destination receiving 692,000 inbound tourists in 2017 and close to 18 million domestic tourists. According to Ctrip, there are close to 333 three to five star hotels in Sanya.

At the moment the city has only one airport, the Sanya Phoenix International Airport, handling 19.4 million passenger throughput in 2017. Construction began on a new airport in 2016 on a 24 sq km artificial island in Hongtang Bay. The new airport which is part of the One Belt, One Road initiative (OBOR) will have four runways and three terminal buildings upon completion and will be designed to potentially handle 60 million passengers annually once fully operational. Trial operation is expected by the end of 2020.

Sanya's future prospects were bolstered in early 2018 with the announcement that Hainan was to establish a free trade zone by 2020 and a free trade port by 2025. Sanya's prospects were further enhanced by extending visa free entry to 59 nations and encouraging horse racing, beach and water sports, and expanded duty-free shopping as well as exploring sports lottery and instant lottery on large-scale international games.

Sanya recently received yet another new addition to its pool of luxury hotels that includes Mandarin Oriental, Ritz-Carlton and Rosewood, with the completion of Atlantis Sanya. The property covers 540,000 sq m overlooking Haitang Beach. There are 1,160 guestrooms plus 154 suites, five of which are palatial underwater suites. The resort also includes a waterpark and aquarium.

Transactions & investment

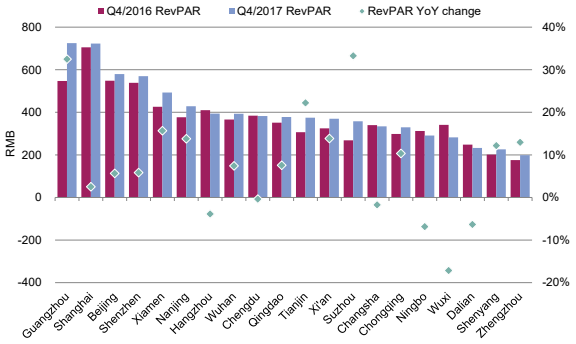
China topped the Asia Pacific region in terms of its transaction volume in 2017. This is mainly attributed to the largest single portfolio transaction in 2017—the sale of Dalian Wanda Group's hotel portfolio of 77 properties, across various cities in China, to Guangzhou R&F Properties. China hotel investment volume in 2017 reached US$4.6 billion in 2017, nearly quadruple the 2016 figure. This strong momentum continued through to the end of the year, and most recent transactions indicate that this trend will remain in place in 2018. In Q1/2018, China registered the highest transaction volume in the Asia Pacific region with US$364.9 million worth of transactions, accounting for 18.4% of total volume.

Investment activity is not only concentrated in the main cities of Beijing and Shanghai, but is dispersed throughout the country.

First tier cities are the densely-populated and established hotel markets. Hotel assets command premium transaction prices reflecting their key economic position in the country, due to the high volume and diversified sources of demand for hotel rooms. Penetration of international brands are high while domestic brands have also flourished. These markets are on the radar of both domestic and foreign investors, who tend to be large groups, professional investors or institutions,

GRAPH 4

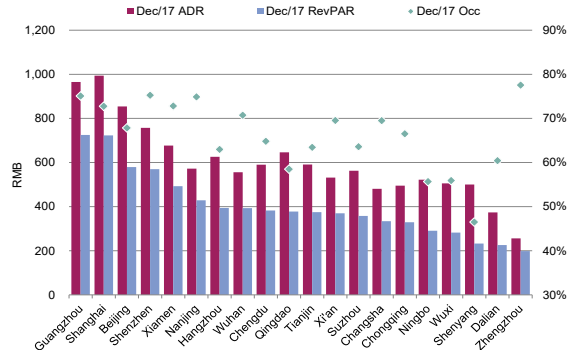
First and second tier city five star RevPAR, Q4/2017



Source: China National Tourism Administration; Savills Research

GRAPH 5

First and second tier city five star ADR, RevPAR, and occupancy rates, Q4/2017



Source: China National Tourism Administration; Savills Research

TABLE 1

China hotel key metrics by city tier, Q4/2017

	ADR (RMB)			Occupancy rate			RevPAR (RMB)		
	17Q4	YoY	Vs 3 yr avg*	17Q4	YoY	Vs 3 yr avg	16Q4	YoY	Vs 3 yr avg
First tier	892.7	9.4%	5.8%	72.7%	1.1 ppts	3.7 ppts	649.3	11.0%	11.7%
Second tier	530.4	(0.8%)	(6.3%)	64.6%	5.0 ppts	6.8 ppts	341.6	6.5%	4.0%
Third tier	497.5	(3.3%)	(8.1%)	59.2%	0.5 ppts	2.4 ppts	297.0	(3.3%)	(4.5%)

Source: China National Tourism Administration; Savills Research
*Vs 3 yr average: This indicator looks at the latest quarter's worth of data and compares it to the average of the same quarter in the three preceding year, Q4/2017 is compared the average of Q4/2014, Q4/2015 and Q4/2016.

who have a long term hold strategy, are willing to take limited risk and are after stable yields. As China's gateway cities, these are the top markets where investors are looking for an entry deal into China.

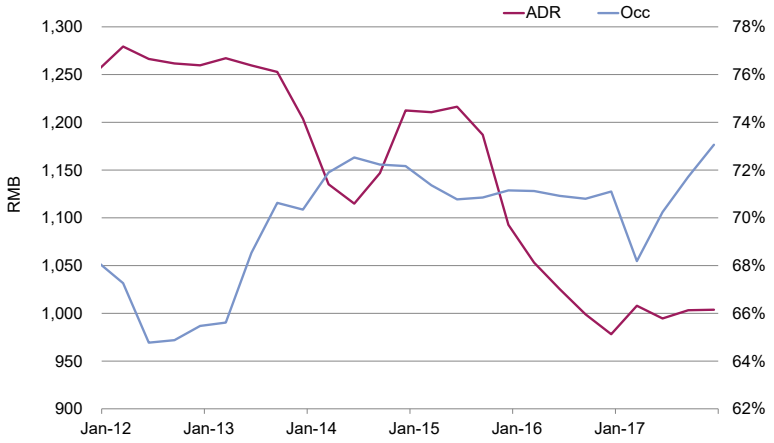
Up and coming cities offer outsized growth potential. These cities have one or two key future demand drivers such a focus on advanced technology or as an emerging hub that is backed at the provincial or central government level. Cities such as Hangzhou and Chengdu belong to this category. These cities attract a balance of leisure and corporate demand and require a wide range of accommodations. Hotel investors have a strong view and are willing to bet on demand drivers, and higher yields in return for the added risk. These markets are dominated by domestic investors, though some of the braver foreign investors and those that have an established presence and experience in China, also venture into these cities.

Hotels converting to residential leasing projects

Many investors are acquiring hotels for the specific purpose of converting them into other uses; for example, rental apartments are becoming popular as the residential leasing market is quickly becoming the darling of the real estate market. The Chinese government—in fact, Xi Jinping himself—has stated its interest in developing this particular sector. Several cities have already

GRAPH 6

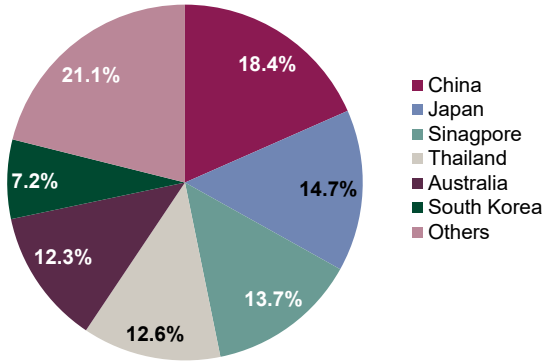
Sanya five start occupancy and ADR (4QMA)



Source: China National Tourism Administration; Savills Research

GRAPH 7

Investment sales transaction volumes by location, Q1/2018



Source: Real Capital Analytics; Savills Research

TABLE 2

Select Shanghai hotel transactions, 2017

Property	Seller	Purchaser	GFA (sq m)	Price (RMB psm)	Purpose
Graceland International Hotel	InfraRed NF	Nova Property Investment	16,300	37,423	Hotel converted into for-lease residential units
Neo Central Park Citadines	Sunac	Gopher Asset	13,665	32,000	Not stated
Shanghai Ming Yue Hotel	Shanghai Ming Yue Group	Everbright Ashmore	36,235	36,290	Hotel converted into for-lease residential units
Puxi New Century Hotel	Individual seller	Nova & InfraRed Nan Fung	24,039	28,287	Hotel converted into for-lease residential units
Changfeng International Building 2	Individual seller	Sincere Properties	30,000	35,000	Hotel converted into for-lease residential units

Source: Real Capital Analytics; Savills Research

implemented favourable policies to promote the development of the residential market. Therefore, it can be safely assumed that these kinds of conversion projects will continue in the future as the residential leasing market becomes more robust and mature.

The rise of asset management
As the hotel market matures in China and other asset classes are not generating the sales or rental returns they have in the past, owners are increasingly scrutinising the financial performance of their hotel assets and paying more attention to their ROI. Owners, particularly the large real estate groups with many hotel assets, are moving away from the traditional asset-heavy approach towards more nimble, asset-light strategies. It is becoming less acceptable to lock up capital that is generating subpar returns and hide or ignore underperforming hotel assets in distant subsidiaries.

However, the rapid market growth has left a shortage of asset management expertise in its wake. In-house asset management teams do not have the experience and required expertise to effectively drive the hotel operator and ensure the optimal financial performance of the asset. The more progressive owners are finding this situation is no longer acceptable and are open to the idea of on boarding external asset management consultants.

Independent asset managers are receiving an increasing number of enquiries from owners who are willing to undertake an independent and sober assessment of the performance of their hotel assets. The assessments often involve objectively benchmarking performance to the competitive set, identifying problem areas and implementing solutions.

In many cases, operational issues are legacies from strategies implemented in previous cycles. Large upscale hotels constructed 10, 15 years ago were overbuilt because they were conceived to maximise GFA instead of IRR. Developers acquired land and built hotels because of the hotel development obligations that the sites carried—often with the requirement to build 5 star hotels, instead of adequately catering to demand fundamentals. Today, there is a mismatch between what these hotels offer and what hotel guests are after, so it is no surprise that these operating assets are struggling to meet performance expectations.

The opportunity is that these hotel assets are located in prime areas and there is significant locked up value waiting to be realised, if only the asset was able to be repositioned to achieve a better market fit.

Owners are not sure what to do with an underperforming hotel management company overseeing their asset. They are well aware that a problem exists but may not be aware of the remedies available to them, whether they be conversion, deflagging, reflagging, repositioning or financial/ownership restricting. They are not aware that creative solutions may exist that do not necessarily involve significant additional capital outlays. In certain cases, disposal is the best option and the asset manager may assist in advising how to structure the transaction to move the asset off the balance sheet in the most efficient manner.

Market news

Retail + hospitality
Muji, a Japanese homeware brand, opened up its first hotel on January 18th, 2018. This is a long—but logical—leap as the brand is well-known for its retailing prowess and not opening up hotels. However, the move into hospitality offers a host of business opportunities; for example, in a clever bit of cross-promotion, 70% of in-room products (toothbrush stands, pillows, chairs, etc.) will be available for purchase. The success of the Muji Hotel could serve as a signal to other retailers to the possibility of opening up their own branded hotels.

Shared space
Landlords and hotel operators are now looking to expand the functionality of their spaces into areas other than just hospitality. A great example of this is Home Inn teaming up with co-working giant UCommune (formally known as URWork); under their agreement, Home Inn will share conference rooms, restaurants, cafes, and other public spaces with UCommune as well as combining resources for membership management systems and discounts between the two services. As hotels are looking to fill their empty spaces, the transitory nature of co-working spaces provides a nice synergy. The team-up between Home Inn and UCommune could serve as a model for hotels to better utilise their space.

International brands franchising to local operators
International brands are looking to leverage local operators' market knowledge and relationships to extend their footprint in China. InterContinental Hotels Group is franchising out their Crown Plaza and two Holiday Inn brands to Chinese operators. This move indicates InterContinental's confidence in local operators to maintain a high level of quality for the brand. A trial run has been in place since 2016 with a total of 68 deals have been signed and six hotels have been opened under this model. Moving forward, other international operators may move to a similar model as the local operator market matures.

Market outlook

Residential leasing – A threat or an opportunity?
Change is coming and hotels in China will have to navigate the shifting sands of the market in 2018. With government policy continuing to promote the residential leasing market, owners can expect more hotels to be converted into rental apartments to take advantage of the tailwinds.

Chinese operators go global
Local hotel operators are gaining more experience and improving their overall service provision, with some, like Greenland's Primus brand, attempting to expand overseas in order to tap into the outbound Chinese tourist market.

Evolving tastes
Chinese consumers' tastes are sharpening and evolving and a crop of home-grown luxury hotels can provide luxury-with-Chinese-characteristics that is both exotic and familiar for outbound Chinese tourists.

Project focus

Muji Hotel

Muji's brand of 'anti-gorgeous, anti-cheap' aesthetic has found its way to Shenzhen, in the form of the Japanese homeware company's first hotel. The UpperHills complex features a unique blend of retail and hospitality—the reception is on the first floor, a Muji store occupies the second and third floors (with a diner on the second floor as well), while the 79-room hotel occupies the fourth through sixth floors. The opening of this hotel represents an unprecedented shift in the hospitality market as retailers are now crossing over into the area. Muji's success in this area could see other retailers expanding into the hospitality area to benefit from cross-sector marketing and sales.

Location	Futian District, Shenzhen
Brand	Muji
Operator	Ryohin Keikaku Co.
No. of rooms	79
Open date	January 18th, 2018
Rate Range	RMB950 for 26-28 sq m with double bed per night; RMB2500 for 51~61 sq m with double bed per night

Source: Muji Hotel (Ryohin Keikaku Co.)

Please contact us for further information

Research

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

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

Zoe Zhou
Associate Director
Asia Pacific
+65 6415 3873
zoe.zhou@savills.com.sg