

# Spotlight Seoul Hospitality

1H 2018



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"Though the number of Mainland Chinese tourists to Korea has declined by 50% as a result of political tensions with China, the number of visitors from other parts of Asia has increased by 9%, leading to more diversification of source markets."

## → Chinese tourists and hotel demand

In Korea, the number of foreign visitors is a major indicator for estimating hotel demand, as 70-80% of hotel room sales revenue is sourced from foreign guests. With the exception of specific years that had major incidents, like MERS in 2015 and geopolitical issues in 2017, the number of foreign tourists has increased on average by 10% annually over the past few years.

In 2017, the number of international visitors was 13.3 million, which was down by 22% from 17.2 million in 2016. There has been political tension between Korea and China over the deployment of the THAAD (Terminal High Altitude Area Defense) system. As a result of the political tension the Chinese government restricted K-Pop concerts and cultural events in China, this also included a ban on selling group tours to Korea. In 2017, the total number of Chinese tourists to Korea declined by about 50%, while Jeju Island was worse hit with a decrease of 75%. On the other hand, the decrease in Mainland Chinese visitors was mitigated by growth in the number of visitors from other parts of Asia; including Taiwan, Thailand, and Vietnam, increased by 9% from 2016.

## Seoul hotel stock

At the end of 2017, the total number of hotels in Seoul was 310 with 48,600 rooms, recording twice the number of hotel rooms than in 2012, when the hotel industry showed its best performance, due to limited stock and increased overseas visitors. Following the easing of approvals for hotel development by the

government, via the offering of FAR incentives to boost tourism and the MICE industry, Seoul hotel stock grew quickly. However, the supply growth of new hotels has started to slow down recently as performance was impacted by oversupply.

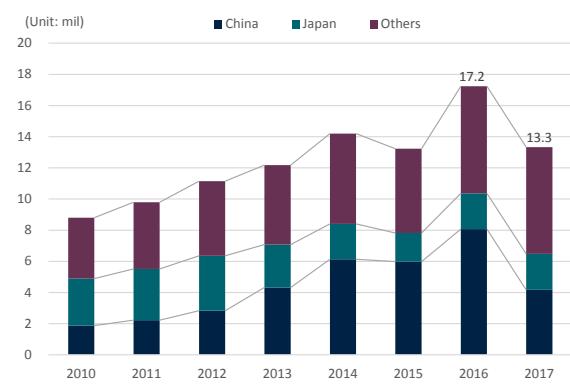
Seoul hotels broken down by classification are as follows: 5-star hotels 26% and 4-star 30%, 4-star showing a higher proportion than 5-star, which inversely accounted for 45% in 2012 (4-star was 25%). As a result of the recent new supply concentration in limited service hotels, the 3-star and 4-star hotel segments have grown to 30% each and the number of rooms has doubled.

Besides that, Airbnb, considered as an alternative accommodation which is not included hotel stock statistics, operates about 20,000 rooms and 50% are located in Seoul.

## Seoul hotel performance

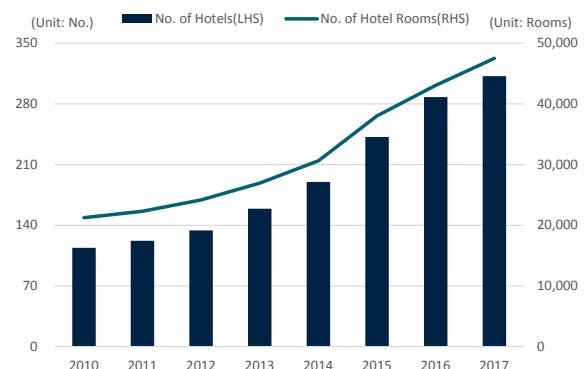
According to data published by the Korea Hotel Association, ADR and OCC in 2016 for 5-star hotels were KRW 198,000 and 73% respectively; and for 4-star hotels KRW 103,000 and 77%. In 2017 the reduced number of Chinese visitors directly affected hotel performance, resulting in an 8-9% decline in ADR and OCC and a decline of 16% in RevPar. Thus, hotel performance in 2017 showed the weakest levels since 2011. Upscale and luxury hotels including the Four Seasons Hotel, Westin Chosun Hotel and the Shilla hotel maintain an ADR of KRW 200,000-300,000, which is higher than the average for 5-star hotels. As hotel room rates are fluid

**GRAPH 1**  
**Overseas tourists and countries of origin, 2010-2017**



Source: Savills Korea

**GRAPH 2**  
**Number of hotels and hotel rooms, 2010-2017**



Source: Savills Korea

based on the room availability in real time, luxury hotels use various marketing programs to maintain their price range and provide various experiences as additional benefits to their guests.

## → Expanding hotel demand from the domestic market

The industry is diversifying facilities and programs to increase their hotel guests from the local market as their room sales are highly dependent on guests from overseas. As a 5 day working week culture is settling in Korea, people consider the balance between work and their personal life as more important and seek leisure time during the weekend. Compared to the past, more people stay in hotels with their family and friends. This type of culture is spreading among young people and they are adopting the international trend of "Staycations". With this new trend, hotels are developing various vacation packages targeting specific people. Paradise City Hotel, a luxury casino hotel in Yeongjongdo, Incheon opened in 2017, has positioned itself as an "art-tainment resort". Hotel visitors can enjoy 2,740 pieces of high quality art in collections from famous artists within an art museum atmosphere. Hotel strategies to lure more guests also include music concerts and culture related classes, as well as kids programs for guests with children.

## Service Integrated with IT system

As the minimum wage in Korea has increased by 17%, it will have a knock-on effect in the increase of operating cost for hotels. Cost efficiency will be considered important and hotels will provide more smart service IT systems, delivering new experiences with higher satisfaction. Hotels like the Westin Chosun Hotel and The Plaza utilise mobile devices called "Handy", they look like smart phones and are placed in each guest room. With a "Handy" device, guests are able to submit a service request that would normally be requested by speaking to the front desk via phone. With this device, hotel guests can make domestic and international calls inside and outside the hotel; they also have internet access, so visitors can use data services without subscribing to their cell phone data roaming service. Increasingly 4-star hotels are also installing smart check-in kiosks.

## Hotel new supply

Based on the development approval data, planned new hotels

will be concentrated in Jung-gu, Dongdaemun-gu, Gangnam-gu, and the Mapo-gu area. In 2017, two luxury hotels, Lotte Signiel Seoul (235 keys) in Lotte World Tower (87-101/FL) and the Grand Mercure (202 keys) in Yongsan Dragon City opened. Also, with better accessibility and improved infrastructure (as the airport express line is connected to Gongdeok and the Hongdae area in Mapo-gu) Glad Hotel Mapo (390 keys) and the L7 Hotel Hongdae (340 keys) completed; while the Holiday Inn Express (294 keys), RYSE Autograph Collection (272 keys), and Kentinn Hotel Hongdae (280 keys) will also be supplied in Hongdae. In addition to this, family and tourism hotels (800 rooms) developed by KT Estate will be delivered in the Dongdaemun area.

## Investment market

In 2017, hotel transaction volumes accounted for 6% of total investment volumes. About 40-50 hotels are owned and operated by institutional investors and those assets will come to market for trade upon fund maturity. Hotel investors participated in deals for forward purchases and hard assets. Most of the hotel investments were transacted under the condition of minimum rental guarantees by hotel operators with master-lease agreements. By these investment conditions, institutional investors can mitigate risk but are limited from improving hotel performance when the asset operation is underperforming.

Usually, the hotel investment market is not hugely active and only a limited number of hotels are transacted. Major hotel deals in 2017 and 2018 were as follows:

In Myeong-dong, Nine Tree Premier (408 keys) managed by Parnas Hotel, was transacted for KRW 135.2 billion (KRW 330 million/key). Nine Tree Premier is master leased for 20 years with the agreement for the higher of the minimum guarantee of KRW 6 billion or 42% of room sales revenue. Shinhan BNP Paribas raised KRW 36.5 billion via a public offering contributing to a total amount of KRW 135.2 billion.

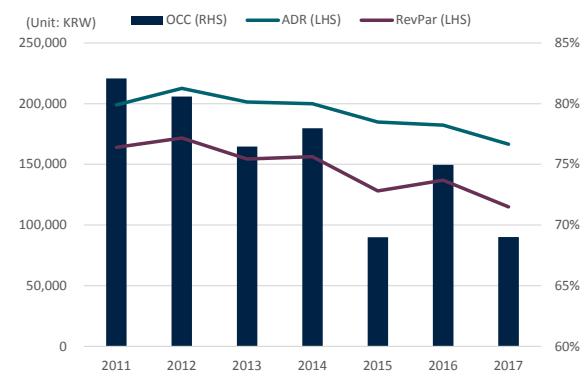
For forward purchase deals, SCPE secured Insa-dong hotel and mixed use development project for approximately KRW 300 billion with

IGIS. The previous land owner was Samsung Fire and Marine Insurance and the hotel will be developed with retail and cultural facilities.

Another hotel development project funded by institutional investors is the Pangyo Chosun hotel (312 keys), which is located in Pangyo Alphadom City close to Pangyo Techno Valley, a cluster location for IT companies. SK D&D and the Chosun Hotel consortium are known to acquire the development site from Pangyo Alphadom PFV for KRW 93 million/3.3 sqm through a bidding process. Supported by high accommodation demand from IT companies in Pangyo and limited new supply, this project received significant attention from investors. The only hotel in Pangyo currently is the Courtyard Marriott (282 keys), a 4-star business hotel, which has shown strong operating performance; with an occupancy rate of 90% and average daily room rate of KRW 165,000.

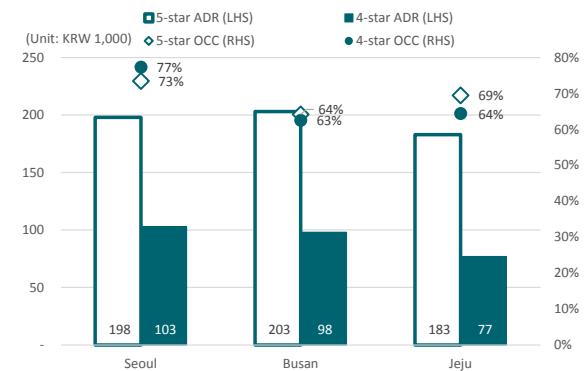
GRAPH 3

## Seoul hotel ADR and OCC, 2011-2017



GRAPH 4

## Hotel performance by major cities, 2016



→ Capstone AMC acquired the Solaria Nishitetsu Hotel Busan, a limited service hotel located in the CBD of Busan, for KRW 36.3 billion. The subject hotel is under 10 years of master lease with a minimum guarantee rent with Nishi-Nippon Railroad Corporation. Solaria opened its first hotel in the upper floors of M Plaza, a retail and hotel mixed-use asset in Myeong-dong where most of the guests are Japanese, resulting in a 70-80% occupancy rate.

In order to improve its financial status, Hyundai Heavy Industries sold its hotel subsidiary stakes, including a hotel portfolio with assets in Ulsan, Mokpo, and Gyeongju, for KRW 200 billion to Hahn & Company, a private

equity fund.

SK D&D bought the Jeju Kensington Hotel and Sangnok hotel site from E-land Group for KRW 128 billion in February 2018. Kensington hotel, a subsidiary of E-land group, will operate the Jeju Kensington Hotel after disposing of the asset and SK D&D will develop the new hotel at the Sangnok site.

Hotel assets that are undergoing current sales processes are both master leased with stable NOI income. The first being the Nine Tree Hotel (144 keys) converted from an office building in Myeong-dong and under long term master lease by Parnas Hotel. The second is the Chosun Hotel which

is part of a mixed-use development project composed of office and retail, it is located behind the Shinsegae Department Store. It is the first boutique hotel operated by the Chosun Hotel and they will master lease the asset for 20 years. ■

TABLE 1  
**Major hotel transactions, 2017-2018**

| Year | Hotel                                   | Location           | No. of keys | Transaction Price (KRW bil) | Seller                          | Buyer                  |
|------|---|--------------------|-------------|-----------------------------|---------------------------------|------------------------|
| 2017 | Nine Tree Premier                       | Jung-gu, Seoul     | 408         | 135.2                       | Ssang Yong Town Development PFV | Shinhan BNP AMC        |
| 2017 | Solaria Nishitetsu Hotel Busan          | Busanjin-gu, Busan | 203         | 36.3                        | How Asset                       | Capstone AMC           |
| 2017 | Ellui Hotel                             | Gangnam-gu, Seoul  | 139         | 80.9                        | Individual                      | Chungdam Penthouse PFV |
| 2018 | Kensington Hotel and Sangnok Hotel Site | Seogwipo-si, Jeju  | 221         | 128.0                       | E-land Group                    | SK D&D                 |

Source: Savills Korea, Public Information

## Please contact us for further information

### Savills Research



**Simon Smith**  
Senior Director  
Asia Pacific  
+852 2842 4573  
ssmith@savills.com.hk



**JoAnn Hong**  
Director  
Korea  
+82 2 2124 4182  
jhong@savills.co.kr

### Savills Korea



**Crystal Lee**  
Acting CEO  
Savills Korea  
+82 2 2124 4163  
csjlee@savills.co.kr

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