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Oman -

Today's Spotlight, Tomorrow's Destination

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Oman – Today's Spotlight, Tomorrow's Destination

By Hala Matar Choufany and Elie Younes, HVS International

Many industry colleagues consider the Middle East hotel markets, and notably the GCC region, to have similar characteristics and dynamics; but is this really the case?

While most GCC markets are similar in terms of their oil-based economies, and the insignificant quantity of natural resources that would support and stimulate a large amount of international leisure visitation, some destinations are just different.

In spring 2005, we visited Oman to advise on the multibillion dollar Blue City development near Muscat. What we saw on our trip confirmed our views.

The Middle East is once again proving to be resilient to the international and regional shocks affecting tourism worldwide. Destinations like Bahrain, Doha, Dubai and Egypt have recently achieved record levels of visitation and Oman seems to be following a similar trend.

In this article, we shed some light on Oman, a newly emerging market with significant opportunities at all levels. The reader should note that we have paid most attention to Muscat, the Omani capital, in our assessment and analysis. The article discusses the following.

- Overview of Oman;
- Political and economic environment;
- Public initiatives;
- Tourism in and visitation to Muscat;
- Hotel market analysis;
- Conclusion and synthesis.

Overview of Oman

The sultanate of Oman is located on the southern tip of the Arabian Peninsula and is bordered by the Arabian Sea to the east. The country has land borders with the United Arab Emirates, Saudi Arabia and Yemen.

The sultanate covers an area of 309,500 km² and has a varied topography: rugged mountains and rocky deepwater fjords to the north (recently rated as one of the best scuba diving destinations in the world), the mountains and green hills of the Dhofar region to the south, and the Wahiba Sands in the centre.

Figure 1 Map of Oman

Oman offers unmatched natural resources and a culture and heritage stronger than those of the other GCC states. There are eight main governates in the sultanate – Muscat, Dhofar, Musandam, A'Dhahira, Al Batinah, A'Dakhliyah, Al Wusta and Al Sharqiya. The main governates are Muscat, Dhofar and Musandam.

- Muscat, the capital of the sultanate of Oman, has a population of over 600,000 and is the commercial heart of the country;
- The governate of Dhofar is located in the south of the sultanate. Salalah, the tourist hub of Dhofar, is known for its greenery and monsoon season. The town has many attractions and is the administrative capital of the region;
- The governate of Musandam lies in the extreme north of the sultanate. It is separated from the rest of the country by a strip of land that forms part of the UAE. Its rugged mountains rise 1,800 m above sea level. Musandam is noted for its strategic position, overlooking as it does one of the busiest shipping lanes in the world.

The sultanate's climate varies from one area to another. Generally, the coastal areas are hot and humid, whereas the weather in the south is temperate. The exception is the governate of Dhofar with its monsoon season, which lasts from June to October. The area is an ideal stopover for holiday-makers who plan to travel around the country.

Political and Economic Overview

Oman enjoys a stable political, economic and social system, which is enhanced by the excellent relationship the sultanate has with its neighbours and the good relationship it has with the USA.

Until recently, the country's economy was run mostly by the government and wealthy local families. However, His Majesty Sultan Qaboos has now started to encourage the development of the private sector as a mean of introducing prosperity and growth, and he has adopted the Oman Vision 2020, as illustrated below.

> *Vision 2020 aims at developing economic and financial stability, reshaping the role of the Government in the economy and broadening private sector participation, diversifying the economic base and sources of national income, globalising the Omani economy, and upgrading the skills of the Omani workforce and developing human resources.*

Oman's foreign policy is guided by the need for the sultanate to take an active role in the global economy. In an effort to enhance foreign direct investment, the sultanate introduced the following initiatives.

- Tax exemptions for five years (sometimes renewable for another five years) for industrial and tourism enterprises that contribute to Oman's economy;
- A 49% equity participation for foreign investors, which may be increased in certain circumstances, and tax and import duty exemptions;
- No personal income tax or foreign exchanges controls;

- Interest-free long-term loans to industrial and tourism projects that are partly foreign-owned;
- The government has recently relaxed the property law, which should stimulate investment and development.

Before the mid 1960s, when oil and natural gas were discovered in the sultanate of Oman, the country's economy was based mostly on fishing, agriculture and traditional crafts such as boatbuilding. Since the slump in oil prices in 1998/99, Oman has actively sought to diversify its economy. Oil production accounted for almost half of the country's gross domestic product (GDP) in mid 1990. Today, the sultanate is geared towards growing the industrial and tourism sector in order to diversify its economy, especially because its oil reserves, in comparison to other countries, are limited.

The Economist Intelligence Unit (EIU) forecasts overall real GDP growth of just 1.5% in 2005, slightly higher than the 0.6% recorded in 2004. In 2006, the economy is expected to expand by close on 6% in real terms as a result of growing private investment and consumption; this will be the highest rate of expansion seen since 2001. The EIU forecasts that annual inflation will rise no higher than 1% throughout the next few years. Generally, the Omani currency is stable (pegged to the US dollar), with inflation never having exceeded 1% since 1992.

Public Initiatives

Tourism in Oman has just started to emerge in comparison to other countries in the Middle East. A directorate of tourism was first established under the Ministry of Commerce and Industry in 2002, and in mid 2004 the government created a dedicated Ministry of Tourism to take over responsibility for all matters relating to tourism. We detail below some of the main initiatives that the government is committed to in order to grow its tourism sector.

Initiatives

- The Omani government increased its tourism marketing budget from US$10 million in 2004 to US$30 million in 2005. A further US$220 million is budgeted to promote Oman over the next five years;
- Full-time government appointees were established in London, France and Germany in 2004, with the aim of raising awareness of the sultanate;
- In order to facilitate and promote tourism, the government eased visa procedures, allowing visitors from 68 countries to purchase visas on arrival at either the airport or border crossings;
- In 2004 the government relaxed the country's property laws, allowing foreigners to own property in tourism-designated areas of the sultanate;

- The government seems to want to facilitate and support the development of new projects. It has already made a number of commitments such as developing the required infrastructure, providing lease incentives, freehold opportunities, and so forth. This would undoubtedly stimulate foreign/regional investment in the hotel sector.

Infrastructure

- US$500 million will be invested to upgrade and expand Seeb International Airport. The expansion will include additional runways and will increase the airport's handling capacity to 25 million;
- The government recently committed itself to a multimillion dollar fund aimed at renovating and improving the tourism infrastructure at many of the country's forts, castles and caves.

Economic Developments

- Between 2003 and 2004 the government signed business agreements worth approximately US$5 billion with a number of American chemical and industrial companies; this should increase business demand and grow the economy;
- The government is committed to encouraging the private sector to invest in industry as part of the framework of the National Tourism Development Plan and it will grant loan subsidies (interest-free loans) for tourism projects with repayment over ten years.

Although the government is dedicated and committed to growing the tourism sector, capital investment and government spending in Oman are relatively lower than they are in other Middle Eastern countries, notably the UAE, Egypt, Bahrain and Qatar. Further public investment is required in order to generate similarly high levels of tourism demand and investment.

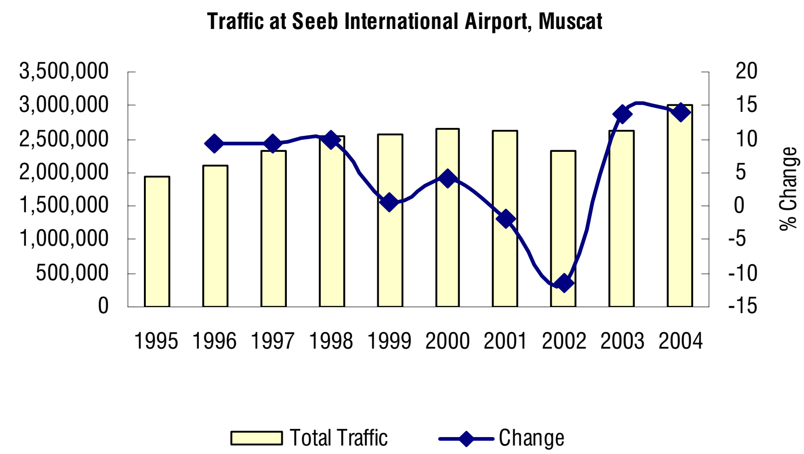
Tourism in and Visitation to Muscat

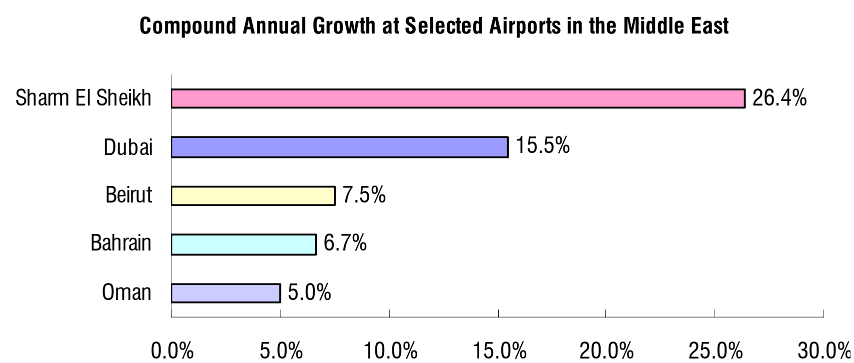
Despite having a land area of approximately 300,000 km^2, unmatched natural resources (compared to other GCC states) and a strong culture and heritage, Oman has seen tourism growth be slow to develop compared to other countries in the Middle East. We focus in the following paragraphs on visitation and tourism trends in Muscat and we compare visitation and the performance of hotels in Muscat to other capitals in the Middle East.

- As illustrated in Figure 2, total traffic at Seeb International Airport (Muscat Airport) has increased at a compound annual growth rate of approximately 5% since 1995. Total traffic dropped by approximately 2% in 2001 and 11% in 2002 due to the events of 11 September 2001, the global downturn in international travel, and the run-up to the war in Iraq. In 2003 and 2004, traffic grew by 14%, due largely to the end of the war in Iraq and the government's marketing and promotional campaign, which raised awareness of Oman in European and Asian feeder markets;

- The historical (the last five to ten years) average annual growth in airport traffic in Muscat has been relatively low compared to other destinations in the Middle East such as Bahrain (6.7%), Beirut (7.5%), Dubai (15.5%) and Sharm El Sheikh (26.4%).

Figure 2 Traffic at Seeb International Airport, Muscat 1995-04



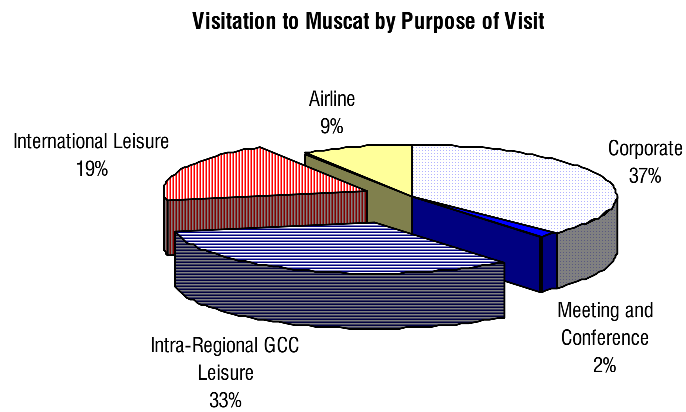


Source: Government of Oman

- In contrast to other countries in the GCC – such as Bahrain, Kuwait, Qatar and Saudi Arabia, which have historically been characterised by business visitation predominantly – Oman is characterised primarily by leisure visitation. As illustrated in Figure 3, approximately 52% of room nights in 2004 were generated from leisure demand and 39% by business demand;

- Charter flights were recently introduced to Oman and these have been quite successful, especially those from Germany, the UK and France. New destinations such as Russia and Vienna were added at the end of 2004. Charter flights have played a major role in increasing tourism at other destinations such as Dubai, Sharm El Sheikh and Aqaba.

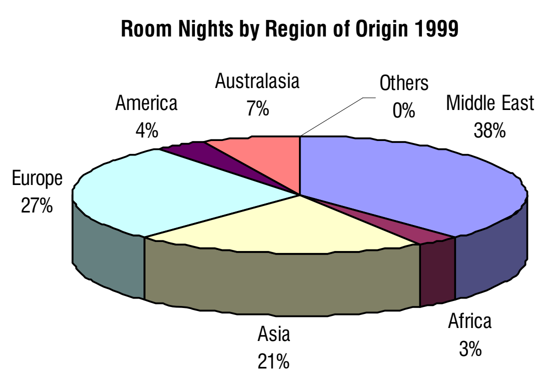
Figure 3 Visitation to Muscat by Purpose of Visit 2004

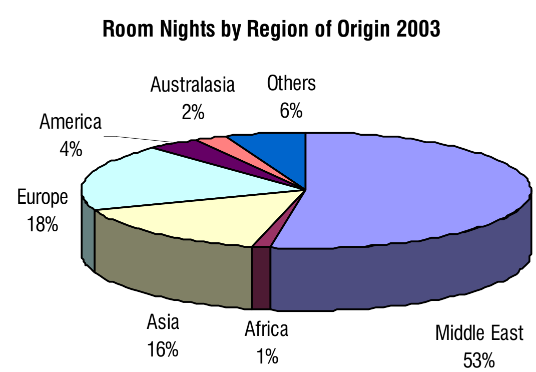


Srouce: Government of Oman

- As illustrated in Figure 4, Middle East countries accounted for 53% of the room nights in Muscat in 2003. Europe accounted for 18% and Asia for 16% in the same year. Both the European and Asian markets dropped significantly between 1999 and 2003, whereas the Middle Eastern market share (of total demand) grew by 15 percentage points;
- In comparison to Dubai and Egypt, which have high levels of international visitation, Oman should further capitalise on its natural resources and attract the European and Asian markets. In 2004, both segments recorded strong growth.

Figure 4 Room Nights in Muscat 1999 vs 2003





Source: Government of Oman

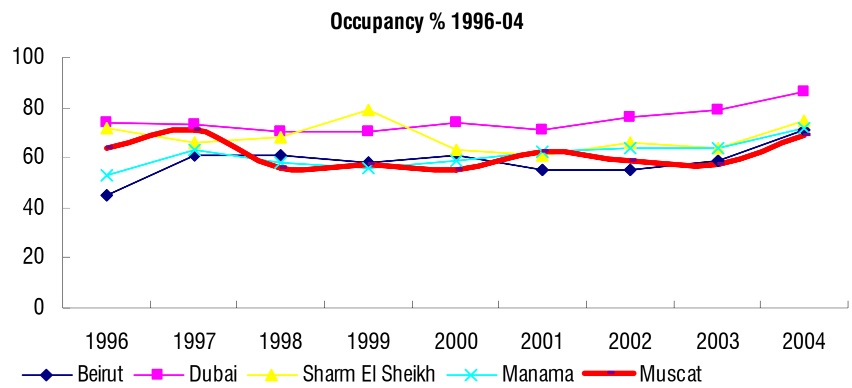
Hotel Market Analysis

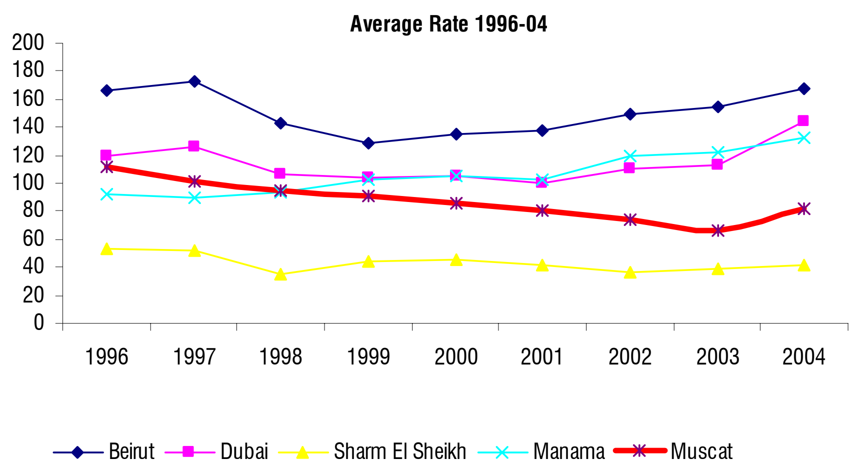
Muscat is now waking up to growing demand, due largely to the government's marketing and promotional campaign, the growth in visitation to the Middle East region in general, and to its location and natural resources. We highlight in the following paragraphs the key trends in the hotel market in Muscat over the last couple of years.

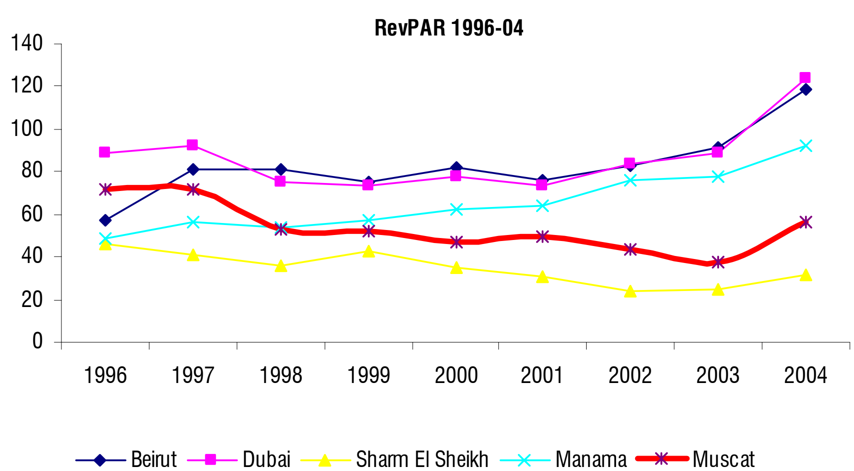
Hotel Market Performance and Demand

- Despite the drop in total traffic passing through Muscat Airport in 2001 and 2002, a decline which was attributable mainly to the events of 11 September 2001 and political tension in the region, the number of tourist nights grew by 7.7% in 2001 and a more conservative 1.0% in 2002. Stronger growth in room nights, of approximately 12%, was recorded in 2003 and 23% was recorded in 2004. The first quarter of 2005 has witnessed significant growth, of approximately 20%, on the comparable period in 2004;
- Occupancy grew by ten percentage points, from 60% in 2002 to 70% in 2004, while average room rate for quality hotels in Muscat grew from US$62 in 2002 to US$75 in 2004: a compound annual growth rate for the period of 9%. As such, RevPAR grew at a compound annual rate of 18%, increasing from US$38 in 2002 to US$52 in 2004. Occupancy and rate for the first quarter of 2005 are significantly higher than they were in 2004;
- Average occupancy over the last ten years in Muscat was 62%, compared to Beirut (58%), Dubai (74%), Sharm El Sheikh (70%) and Manama (61%). This reflects the potential for the market to experience considerable growth in the future, especially considering the small amount of supply within Muscat;
- Figure 5 shows the occupancy, average room rate and RevPAR for quality hotels in Muscat and its key regional competitor cities.

Figure 5 Comparative Occupancy, Average Rate and RevPAR 1996-04







Source: HVS International

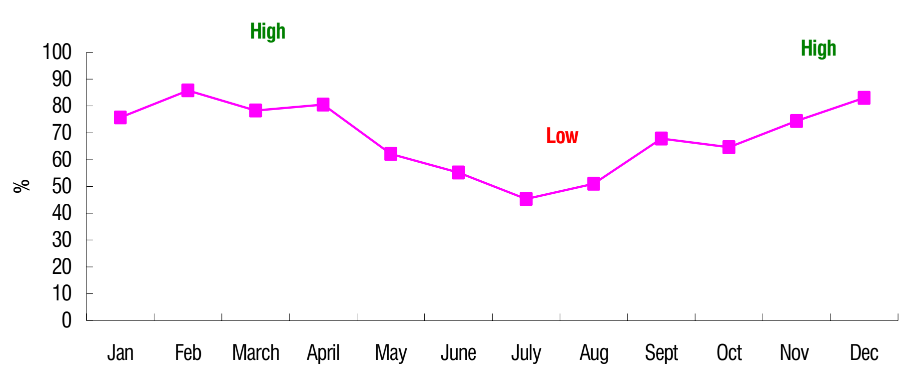
Hotel Operations

- In Muscat's four-star and five-star hotels food and beverage revenues account for between 40% and 45% of total revenues, while rooms revenue generates between 45% and 50% of the total revenues. This is typical in most GCC countries, given that the consumption of alcohol is only permitted on hotel premises. Most restaurants and clubs within the hotel attract a high number of non-residents, and, as such, the contribution of food and beverage to total revenues is higher when compared to European countries, where it is typically in the range of 25-35%;
- In keeping with other GCC destinations, employee to room ratio is more than 2:1, much higher than it is in most European markets. Moreover, we note that labour cost/wages in Muscat are relatively low;
- The hotel investment arena in Muscat has historically been characterised by a local pool of investors. However, increased regional and international investment has been noticeable recently. This will be further stimulated by the public initiatives designed to attract foreign investors and grow the industry. In addition, the multibillion dollar Blue City development (anticipated to be a 'free zone') is expected to attract a significant amount of foreign investment into the country.

Seasonality

- The hotel market in Muscat is highly seasonal. The high season typically runs from September to March, and slows in April and May. The low season begins in June and lasts until August, as shown in Table 6. However, recent trends show that the seasonality is being smoothed throughout the year.

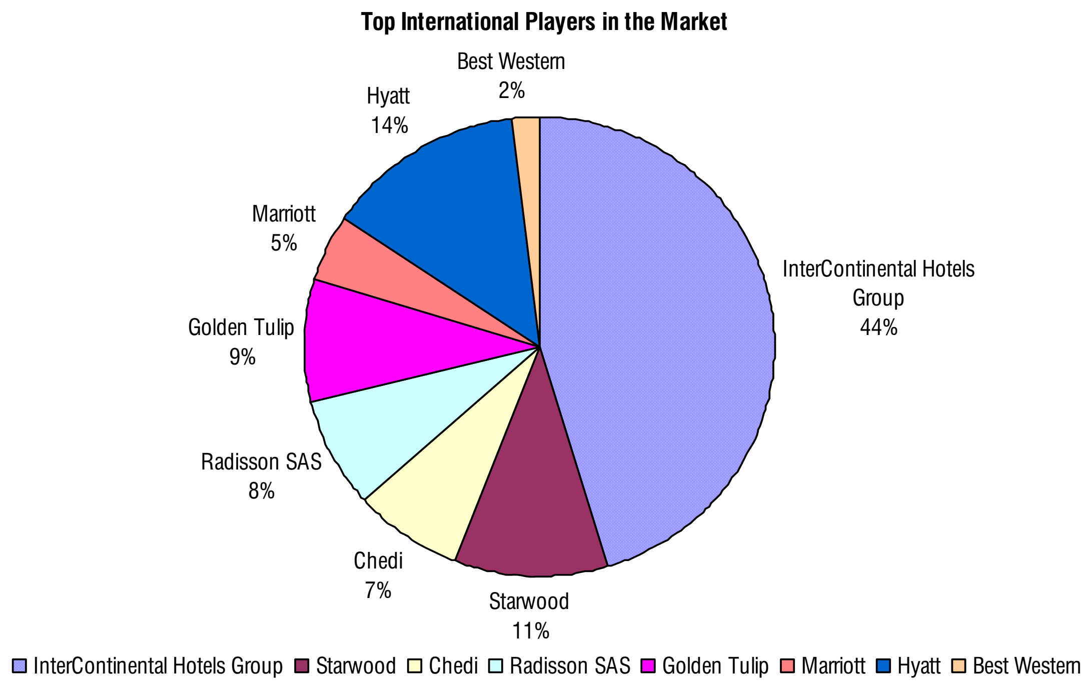
Figure 6 Hotel Demand Seasonality in Oman 2004



Supply

- Currently, there are a total of 12 internationally branded quality hotels in Muscat, totalling some 2,030 rooms. The main international player in the market is InterContinental Hotels Group with a 44% share of the total number of branded quality rooms in the market.

Figure 7 International Hotel Distribution in Muscat 2004



Source: HVS International

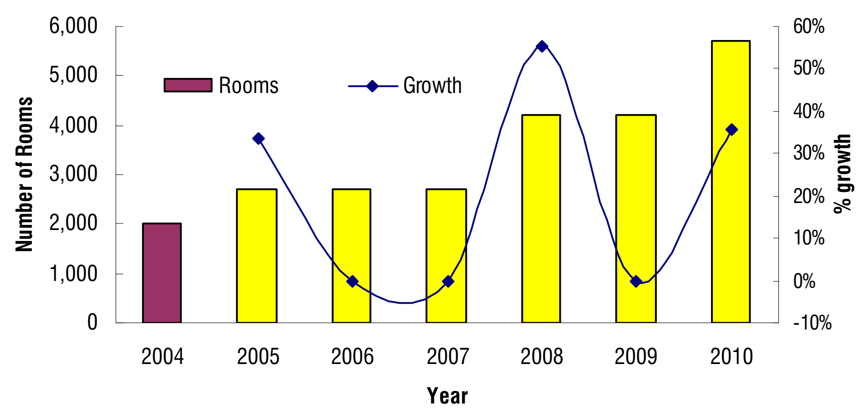
- By the end of 2005, three Shangri-La hotels with a total of some 683 rooms will have entered the market. The Waves Waterfront project, situated in close proximity to Seeb International Airport, will feature at least five hotels, with a total of some 1,500 rooms, and is due for completion by 2009. Rumours abound concerning the opening of a Ritz-Carlton and a Four Seasons hotel in the next three to five years;

- The major urban economic development in the country is the Blue City Development in Barka, on which HVS International advised, an hour's drive west of the city of Muscat. The aim of this project is the development of a fully integrated city, with some 200,000 inhabitants (permanent and temporary), schools, hospitals, tourism services and facilities, a port, an amphitheatre, a shopping mall, a souk and an international village. The project will feature in its first phase five hotels, with some 1,500 rooms. Upon completion of the whole project, the total number of hotels will be approximately 20 (by 2020). The US$10 billion Blue City Development is expected to attract high levels of foreign direct investment and generate approximately 25,000 jobs;

- Other projects around Muscat are Ras Al Hadd, the Mirbat Tourism Village and other rumoured mixed-use developments. We note that there are ongoing projects in other governates such as Musandam and Salalah;
- Approximately US$5 billion will be invested in the tourism sector across Oman between 2005 and 2010. Other, presently confidential projects should also come on stream in the next five years.

Figure 8 illustrates the future supply growth in the market.

Figure 8 Existing and Future Room Supply Growth, Muscat 2004-10



Conclusion and Synthesis

Overall Market

- Oman benefits from a stable economy and a stable political environment. The government has undertaken several initiatives and offered incentives to encourage private investment and improve the tourism industry;
- Given the significant potential of the market, and the government's commitment to growing the tourism industry, we expect the sultanate to experience strong growth in demand for hotel (and hotel derivatives) accommodation;
- Most neighbouring GCC countries benefit from greater economic wealth; this in turn translates into a higher level of public investment and promotions of their tourism industries. However, given the cultural and geographic characteristics of the country, Oman could

differentiate itself by capitalising on its natural resources and setting an appropriate tourism strategy;

- The main feeder markets to the area in the future are the GCC countries, Europe and Asia;
- While the country is not yet firmly positioned on the international tourism map, we expect the market dynamics in Oman to undergo significant, encouraging changes in the short to medium term.

Hotel Market

- The operating performance of quality hotels in Muscat has grown substantially over the last couple of years;
- We expect the hotel market in Muscat to experience substantial growth in 2005 when compared to 2004. This will undoubtedly stimulate investor appetite in the market;
- We note that over the next ten years, the supply and demand dynamics might result in a short-term 'market shock', a natural occurrence in emerging markets when a significant level of new supply enters the market within a short period of time.

Hotel Investments

- We consider that investment opportunities exist in various hotel assets in this market, notably in the following areas;
  - Branded full service hotels (perhaps with a boutique cachet, as has been successfully demonstrated by the Chedi hotel);
  - Branded limited service hotels;
  - Branded serviced apartments;
  - Other asset classes such as condos (rental pool), timeshare and fractional properties.
- Historically, the hotel market was characterised by a local pool of investors; however, we anticipate an increased level of regional investor appetite in the near future;
- We expect that many financing (and refinancing) transactions for proposed and existing hotels in the market may take place in the short to medium term.

About the Authors

Hala Matar Choufany is a Consultant & Valuation Analyst with HVS International's London office. She joined HVS in January 2005, having had four years' operational and managerial hotel industry experience and one year of consulting experience in the Middle East. She has also lectured at Notre Dame University in Lebanon on International Travel and Tourism. Hala holds an MBA from IMHI (Essec Business School, France and Cornell University, USA) and a BA in Hospitality Management from Notre Dame University, Lebanon. Since joining HVS, she has conducted several valuations, feasibility studies, and market studies.

Elie Younes is an Associate Director with HVS International's London office, heading the Middle East and Africa region together with Bernard Forster. He joined HVS International in 2001 having had four years' operational and managerial experience in the hospitality industry in the Middle East. Elie benefits from his diverse multicultural background and speaks Arabic, English and French. He holds a BA in Hospitality Management from Notre Dame University in Lebanon, an MBA from IMHI (Essec Business School, France and Cornell University, USA) and is currently preparing his MSc in Real Estate Investment at Cass Business School in London. Since joining HVS International, Elie has advised on and valued various hotel (single assets, portfolios, and company valuations) resorts, and extended stay projects in Europe, the Middle East and Africa. He has also given strategic advice on mid- and large-scale developments and investment ventures in the Middle East.

About Our Team

HVS International has a team of Middle East experts operating in the Middle East and North Africa (MENA) region. The team benefits from international and local cultural backgrounds, diverse academic and hotel-related experience, in-depth expertise in the hotel markets in the MENA region and broad exposure to international hotel markets in Europe. Over the last 24 months, the team has advised on more than 60 hotels or projects in the region for hotel owners, lenders, investors and operators. Together, this team has advised on more than US$7 billion of hotel real estate.

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