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Middle East Hotel Market: Year-End 2019 Review & Near-Term Outlook

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It is amidst a turbulent economic outlook and political instability that the region continues to diversify its economic reliance on oil production and to commit large investments on tourism and non-oil related sectors. The Middle East region continues to face distraught on the back of ongoing political conflicts and a fragile energy sector. The region has undergone a range of socio-political and economic shifts that have undoubtedly continued to impose ramifications pertaining to the ME hotel industry.

The Middle East region welcomed 62 million international tourist arrivals in 2018, equivalent to 6% of the world's total arrivals. International visitation increased another 8% during the first six months in 2019, and this growth is expected to be registered on annual basis over the next five years based upon a number of key developments in the region, notably Expo 2020, Qatar World Cup 2022, and the transformational vision of the Kingdom of Saudi Arabia.

Accommodated room nights in the Middle East continues to grow, having registered approximately 10% annual growth since 2010, yet the overall hospitality outlook remains cautious, and the declining hotels' operating income calls for immediate corrective measures in order to sustain and grow hotel values. Atop the macroeconomic and socio-political landscape, HVS data indicate that the Gulf Cooperation Council (GCC) and Oman hotel market performed at an average occupancy level of 61% in 2019, two percentage points higher than 2018. Occupancy for those countries averaged 60% for the historical ten-year trend (2010–2019), registering 63% for the historical 22-year period (1998–2019), with the UAE consistently outperforming the GCC average hotel occupancy.

We take the view that a number of demand generators will induce additional room nights in each of the GCC countries over the next five years (2020–2024). Therefore, we forecast Qatar's occupancy to average 62% for that five-year period given the ongoing developments and the 2022 World Cup. Major projects and government initiatives in KSA should allow the country to achieve a countrywide occupancy level of 66% for that period. UAE specifically continues to introduce new projects, and Expo 2020 will support growth in occupancy to average near the 75% mark during the next five years. Bahrain, Oman, and Kuwait should also register a rise in demand, largely attributed to the government tourism initiatives and overall policy reforms to support international investments and tourism growth. Despite the projected growth in room nights over the next five years, total supply in the GCC and Oman is expected to increase by 55%, which will hinder a significant growth in overall occupancy levels.

Years	Bahrain	Kuwait	Oman	Qatar	KSA	UAE
1998	58	46	56	72	62	68
1999	56	47	57	61	61	67
2000	59	46	55	58	62	71
2001	62	49	62	56	60	69
2002	64	53	59	60	61	72
2003	64	84	57	72	59	74
2004	72	64	69	72	55	84
2005	75	70	80	71	61	84
2006	71	65	74	71	67	84
2007	77	58	67	71	72	84
2008	75	62	68	70	63	78
2009	68	59	62	58	64	68
2010	66	54	62	66	55	63
2011	34	58	60	59	57	70
2012	49	58	65	63	60	72
2013	49	59	58	64	63	74
2014	55	53	60	76	67	68
2015	53	53	64	69	63	71
2016	53	53	57	62	58	69
2017	52	63	55	55	55	70
2018	54	52	62	55	58	71
2019	56	56	63	58	59	73
22 year average (1998-2019)	**60**	**57**	**62**	**64**	**61**	**73**
Last 10 year average (2010-2019)	**52**	**56**	**60**	**63**	**60**	**70**
Last 5 year average (2015-2019)	**54**	**55**	**60**	**60**	**59**	**71**

The entrance of additional hotel rooms to the GCC market will continue to impact the achievable average daily rate, despite the potential demand induced by new developments and government initiatives. When looking at the last ten years, ADR in the GCC countries averaged approximately $180 USD, with Bahrain, Kuwait, and Qatar over-penetrating the GCC's market-wide ADR. Overall, average rates in the region dropped by approximately 20% to 25% in the last five years because of new supply additions and more competitively priced hotels.

HVS forecasts countrywide ADR in the UAE, Oman, and Qatar to remain stagnant, while KSA is likely to benefit from the recent changes in tourism government policies and experience moderate ADR growth. Bahrain and Kuwait will both register further drops in market-wide average rate due to increased competition and the phasing out of the hotel rate cartel agreement effectuated by the hotel owners' association.

Declining RevPAR levels, coupled with increasing operating costs, resulted in a 14-percentage-point decrease in hotel net operating income across the region, from 40% in 2013 to 26% in 2019. Consequently, the changes in operating performance affected the hotel values, which experienced significant drops and an all-time low in 2018, with a regional average value per key of $208,000 USD (four- and five-star hotel assets). The 2019 regional average value is expected to register an additional decrease of 3% over the 2018 amount.

Concluding Thoughts:

There is no doubt that the region will continue to grow its hospitality offering and attract larger share of the international tourism arrivals, but it is time for investors to stop overspending, hotel operators to streamline their operations and create value, consultants to flag the serious financial risks and potential rewards, and tourism authorities and related government entities to support balanced growth.

As primary markets continue to mature and become saturated with four- and five-star hotels, and as secondary markets begin to progress, supported by improved modes of accessibility and infrastructure development, the Middle East will continue to present attractive investment opportunities.

With so many uncertain and contradicting views about the future performance of the hotel industry, ongoing mergers and acquisitions, the fierce competition of the traditional hotel model with Airbnb and residential units, technology disruption, rising operating costs, declining RevPAR, and changes in guests preferences, to name a few, the only sure thing is that we need to become more sophisticated, innovative, and realistic in the way we invest, build, partner, and operate hospitality assets.

We encourage investors, operators, and key stakeholders to consider the following critical factors, which will continue to have a detrimental impact on current and future values, and to understand that once the asset is built, the value is determined by its income stream potential.

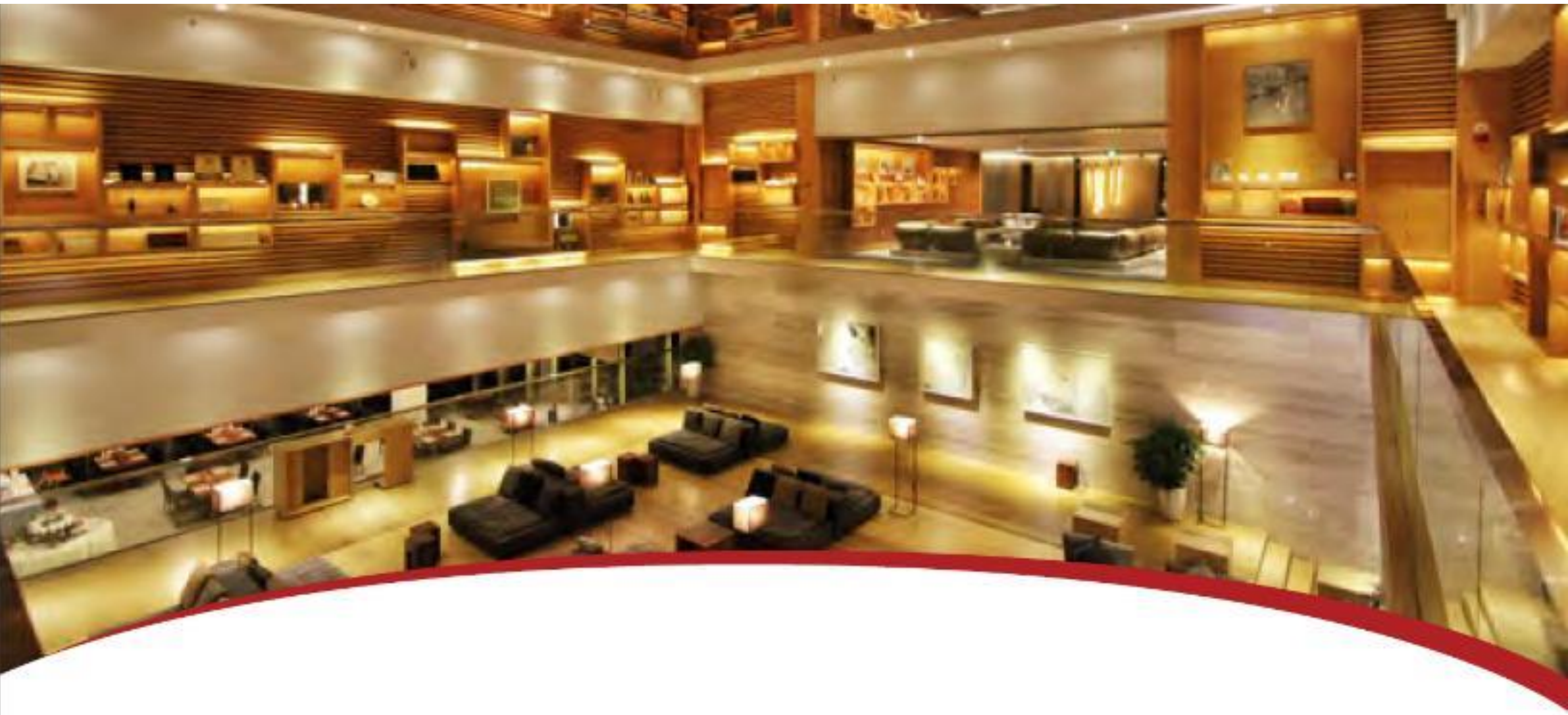
a. Develop efficient schemes that focus on revenue generated by the amount of built-up space. Implementing value engineering has become more critical towards long-term efficiency and value creation.

b. Question the need of back-of-the-house space and public facilities, restaurants, amenities, and whether they will create an added value or an additional cost.

c. Develop a hotel that future generations will use and anticipate changes in preferences, customer base, and spending habits.

d. While operators have so far had an upper hand in dictating brand standards in this region, owners should ensure that the investment is justified with the potential earning and returns. An alignment of future income with the proposed brand and development schedule is more critical than ever.

e. Evaluate the capabilities of the operator and the proposed brand, negotiating the operator/manager fees to ensure that compensation is linked to value creation.



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