

# ***The Great Mid-market Hotel Debate***

## **Are we ready for the future?**



### ***At a glance***

The GCC hotel market is dominated by luxury, up-market establishments, however, with growing importance of emerging millennial travellers, global traveller trends have shifted dramatically. More and more travellers, even those who can afford luxury, are opting to stay in affordable hotels. The reason for this shift includes the rise of the affluent middle class, especially in Asia which has opened up new opportunities for investors in the GCC hotel industry. Additionally, with the region preparing for mega-events such as the Expo 2020 in Dubai and the FIFA World Cup 2022 in Qatar, it is imperative that GCC countries widen their accommodation choices to include mid-market hotels.

Dubai has spent the last decade establishing and marketing itself as a 'luxury' destination with a large presence of international luxury hotel brands. The city is now moving towards destination maturity attracting a diversified tourist profile and an enhanced product offering including large-scale theme parks.

Opening itself to mass markets such as China and India, the development of large-scale tourism projects, the trim-down of corporate travel budgets during trying periods and the consumer behavior of the millennial traveler, it is important for Dubai to address the skew of its hotel supply towards the luxury hotel sector and open its door to welcome more budget-friendly mid-market, i.e. 3 and 4 star hotels, into the mix.

### ***This paper answers the key pertinent questions such as***

- What drives the Dubai hotel market?
- What are the key characteristics of a modern mid-market hotel?
- How does Dubai hotel supply stack up to other destinations?
- How many mid-market hotel rooms do we need?
- What are the key challenges holding back mid-market hotel development?
- Do mid-market hotels make financial sense?

## What makes a good mid-market hotel?

The millennial travelers are the key target markets for most of the mature and upcoming travel destinations globally. These travelers range between the ages of 18 and 34 and contribute almost USD 200bn to USD 300bn in annual spending worldwide (2014 US census). These numbers are too large to brush aside.

The one thing that millennial travelers have in common is their search for quality and quality doesn't necessarily mean luxury. They're slowly moving away from the large impersonal rooms of the traditional-luxury hotel properties and moving towards the trendy and technology friendly hotels regardless of their star category rating.

Mid-market hotels are no longer dull, room focused developments. They are emerging as trendy, designer properties focused on providing facilities that are considered essential for the millennial traveller. The most important requirement in a hotel for these travelers is a well connected location, clean rooms, great, free WIFI, apps and accessibility via various technology platforms.

## What drives the Dubai hotel market?

Traditionally, the upscale hotel segment has been driving regional hospitality sector growth for the last decade. Currently accounting for 32% of the total hotel rooms inventory in Dubai, five star hotels have grown at a CAGR of ~10% between 2012 to 2015, compared to a CAGR of 2.5% for budget/economy hotels in the same period. However, with Dubai's 2020 vision of welcoming 20 million tourists to the city supported by economic diversification plans, and a future calendar of world-leading events, Dubai is now recognizing the potential demand for mid-market accommodation.

The Department of Tourism and Commercial Marketing - Dubai (DTCM) has focused marketing efforts to increase tourism from India and China have caused a shift in Dubai source markets. India currently represents the top tourism source market and the Chinese market has grown by 29% from 2014 to 2015.

Both India and China are destinations that have a diversified tourism offering of various income levels. To maintain the tourism flow from these countries, it is imperative that there exist a large hotel offering in Dubai ranging from 5-star properties to budget properties.

### Volume-Centric

Leverage the additional rooms that can be built on a piece of land relative to a five star property

Room Sizes

15-25 sqm

### EBITDA

35% - 45%

### GOP Margin

45% - 55%

### CAPEX and FF&E Requirements

Cost per key for mid-market hotels can be as low as USD 80k per key.

### Facilities

Typically 'no-frills', with lodging being the focus.

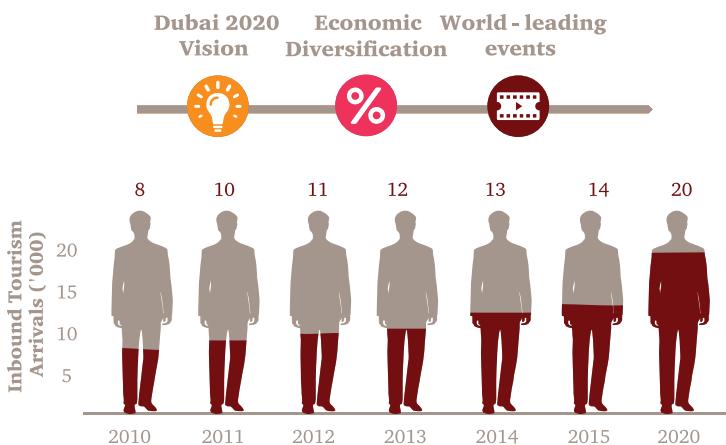
### Land requirements

A typical plot of land that can accommodate 250 five star rooms may be able to accommodate 400+ mid-market hotel rooms

### Connectivity

Well connected with city centres via public transport with robust infrastructure

## Dubai Inbound Tourist Arrivals



## Top 5 Source Countries - 2015



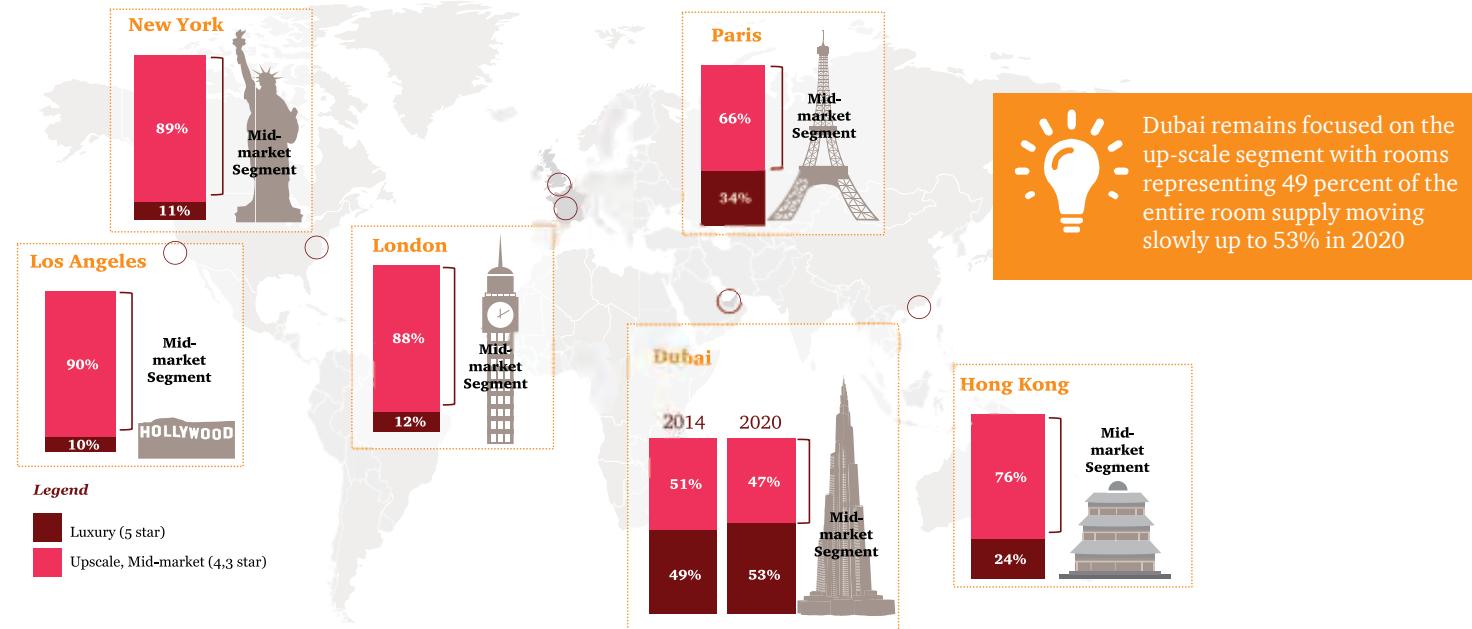
## Top 5 Source Countries - 2010



## How does Dubai hotel supply stack up to other destinations?

As a destination moves towards maturity and opens itself up to diverse source markets of differing income levels, the supply composition of the hotel supply is distributed evenly among all the star categories.

Dubai's existing hotel supply still leans towards the five-star luxury sector as the initial destination marketing efforts were targeted towards the upper-class spectrum of the market in order to achieve higher tourism spends.



## How many mid-market hotel rooms do we need?

Dubai has steadily climbed the international tourism destination ladder over the past years overtaking many mature destinations in the process. To achieve the 20 million visitation target by 2020, the focus will need to shift to mass markets - a process which has already started as evidenced by DTCM's targeted marketing towards countries such as India and China, as well as the various leisure and entertainment attractions that are planned for the city. Given the shift in demand, it is imperative that Dubai bridges the gap in current supply to cater to the varied accommodation requirements of these emerging markets.

### Current Supply

98,333 hotel and hotel apartment keys

### Future Supply (2016-2020)

20,363 additional keys of which approximately 56% are expected to be within the five star segment

### Demand Supply Gap

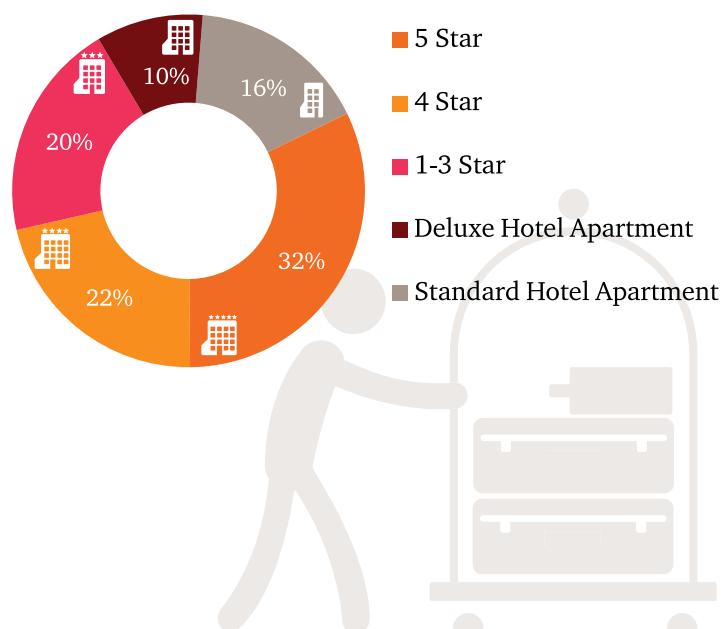
PwC estimates an additional 15,000 room keys are required to service demand from the 20 million visitors targeted by 2020.

If the entire additional inventory required by 2020 were to fall within the mid-market category, the luxury to mid-market hotel keys split in Dubai would be 48:52, inching closer to the inventory mix of Paris (34:66). While this is still far from the ideal destination mix, such a scenario would result in the total mid-market hotel rooms in Dubai being able to accommodate ~30% of the total visitors anticipated by 2020.

## Top Global Destination Cities by Overnight Visitors

Rank	2012	2013	2014	2015
1	London	Bangkok	London	London
2	Paris	London	Bangkok	Bangkok
3	Bangkok	Paris	Paris	Paris
4	Singapore	Singapore	Singapore	<b>Dubai</b>
5	Istanbul	New York	<b>Dubai</b>	Istanbul
6	Hong Kong	Istanbul	New York	New York
7	Madrid	<b>Dubai</b>	Istanbul	Singapore
8	<b>Dubai</b>	Kuala Lumpur	Kuala Lumpur	Kuala Lumpur
9	Frankfurt	Hong Kong	Hong Kong	Seoul
10	Kuala Lumpur	Barcelona	Seoul	Hong Kong

### Current Dubai inventory Breakup



## What are the key challenges holding back mid-market hotel development?

	<b>High Land and Development Cost</b> Land in the accessible prime hotel clusters across Dubai comes at a very high price rendering the development of budget properties within these clusters as unfeasible with comparatively lower returns.
	<b>Lack of public transportation connectivity</b> To be profitable, budget hotels are generally situated in second-tier locations in Dubai. Such locations are usually not very accessible via public transportation which could be a possible deterrent for the price-conscious consumer.
	<b>Developer Perception</b> Developer perception within the region focuses on the development of "trophy assets" in the form of luxury hotels in prime locations. This trend is gradually changing with prominent developers rolling out a portfolio of mid-market and budget hotels.
	<b>Low Barriers to Entry</b> There is a higher risk of developing mid-market hotels due to lower barriers to entry. Mid-market hotels also tend to be vulnerable to rate fluctuations in the 5 and 4-star market and economic headwinds.
	<b>Support Infrastructure for small to medium investors</b> To promote investments in the mid-market hotel sector, it is imperative that there exists a strong support infrastructure for all sizes of investors, including lending and construction support.

## Do mid-market hotels make financial sense?

The often quoted challenge that supposedly holds back mid-market hotel development is the high price of land in prime locations of Dubai. High land prices is claimed to make the economics of building a mid-market hotel often less financially attractive than a five star property. While the higher five star rates coupled with the current high occupancies enjoyed by the five star hotel market in Dubai does make for an attractive investment opportunity, we believe that developing a mid-market hotel on the same plot of land can result in similar cash flows to the developer/owner.

### Illustrative Example (for a plot of land with allowable GFA of 22,500)

Allowable GFA assumption	Rooms	Occupancy	Average Rates (AED)	Rooms Revenues (AED)	Departmental Profitability	Cash Flows to Bottom line (AED)
<b>Five Star Hotel</b>	22,500	250	75%	900	61.6mn	80%
<b>Mid-market hotel</b>	22,500	521	85%	350	56.5mn	85%

Owing to the lower rooms size requirements, coupled with lesser landscaping areas, recreational activities, lax requirements for a pool, spa and other ancillary facilities, a typical plot of land that can accommodate 250 five star rooms may be able to accommodate 500+ mid-market hotel rooms on the same plot of land with the same allowable GFA. With the increasing demand for mid-market hotel rooms, properties in prime locations should be able to achieve superior occupancies relative to five star properties. Coupled with the lower operating costs of a mid-market hotel, this will result in the same cash flows to the bottom line for the Owner.

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