Developing a Sustainable Dubai

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Introduction

Dubai is the most developed market in the Middle East and has enjoyed first-mover advantage over recent years. Dubai's hotel market has enjoyed significant growth supported by a large number of public and private investments as well as major infrastructure improvement. With the beginning of the economic crisis hitting the major source markets almost two years ago, and grasping onto the region last September, Dubai has been forced to re-examine the procedures and strategies of the hotel sector in the city.

This article examines the hotel market in Dubai. We will comment on the historic performance as well as focus on the apparent sustainability of Dubai's hotel market as it stood before the crisis. We will then comment on the effect of the current economic situation on Dubai's hotel market in addition to commenting on the expected future hotel market supply and performance of Dubai hotels. Furthermore, we will share HVS' outlook for Dubai.

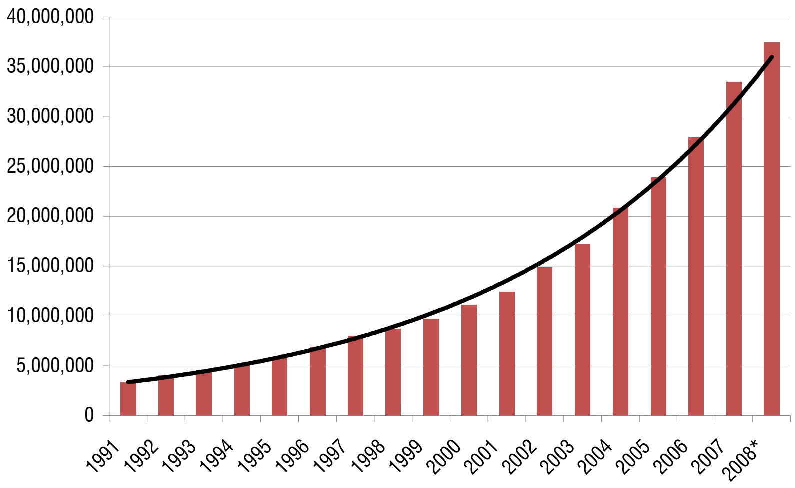
Dubai in the Spotlight

Hotels in Dubai have experienced a long period of strong growth since the turn of the century and this has subsequently translated into high levels of profitability for the existing hotels. Owing to this unprecedented level of growth, many developers and operators were enticed into entering the market and, as such, a large scale of mixed-use developments were announced, each with at least one hospitality component.

By the end of 2008, the number of hotels in Dubai increased to 341 indicating a growth of 3.2% since the turn of the century with five-star and four-star hotels showing the strongest growth increasing 10.5% and 11.0%, respectively. The number of available rooms increased by 7.9% during the same period with the majority of additional rooms being accounted for in the five-star and four-star categories.

This growth in room count was fuelled by the increase in passenger arrivals to Dubai. With the easiness of travel from the Dubai airport many passengers were inclined to spend two to three days in the Emirate enjoying the various tourism sites that the city has to offer. From the turn of the century, passenger arrivals have increased by 16.4% with exceptionally strong growth between 2004 and 2008 illustrating a growth rate of 15.7% during that period.

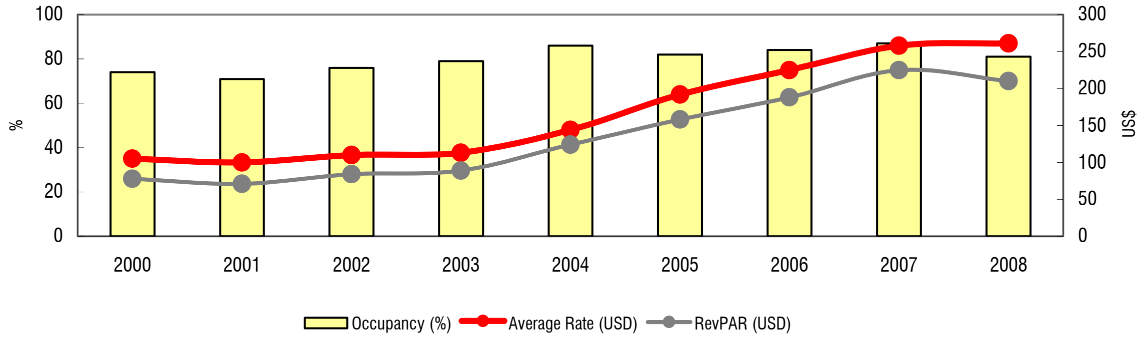
Figure 1 Passenger Arrivals – Dubai Airport 1991-08



Source: ACI Worldwide Airport Traffic Report (1991-2007)
*Source: Airport Direct

Although supply was increasing steadily and new projects were being announced daily, hotels did not suffer from lowering occupancies, average rates nor revenue per available room (RevPAR). In fact, Dubai was the leader in terms of RevPAR for the region in 2007 and comparable in terms of other top worldwide destinations. Furthermore, Dubai was being portrayed as a phenomenon for the hospitality industry in that five-star hotels were commanding rates well above US$200 (over the last three years) and maintaining occupancies above the 80.0% mark. This allowed them to achieve RevPARs well above the norm with a peak of US$225 in 2007.

Figure 2 **Performance of Hotels in Dubai 2000-08 (US$)**



Source: HVS Research

Dubai's tourism industry has experienced significant growth over recent years owing to the efforts of the public and private sectors of the economy. In addition to its strategic positioning in the Middle East, Dubai has been able to diversify its economy, moving away from the need for oil revenues to maintain the economy and concentrating on developing the emirate as a tourism hub for commercial and leisure tourists coming to the area. Furthermore, Dubai has benefitted from the early development and has since positioned itself as the investment capital of the Middle East enticing residents of neighbouring Gulf Cooperation Council (GCC) states to invest in the city. The tax free incentive, the development of free zones allowing private companies to set up offices in the area, and the easy access to a vast labour market has enabled Dubai to position itself as the leader in the region.

The Bubble

Until 2008, Dubai was expected to continue its boom throughout the first decade of the century. As previously mentioned, owing to the unprecedented growth and the expectation for it to continue, a number of mega-developments were announced that were expected to induce demand to triple or quadruple tourist arrivals to the area. Retrospectively, we realise that this would have been very challenging for the market. Although Dubai was expecting to offer visitors everything under the sun, the growth of other worldwide tourist destinations would have hindered the likelihood of repeat visitation to the area, causing an eventual stabilisation of arrivals. In order for Dubai to achieve acceptable levels of occupancy, demand would have had to increase to unprecedented levels to rationalise the increase in capacity.

A major factor overlooked by the developers in the area was the need for a range of hotel offerings for the various types of client. The increase in demand would have led to Dubai being deemed a mass tourism destination, however many announced developments, until June 2008, were focused on the luxury segment of demand which represents the smallest portion of the industry. This contradicts the fundamentals of being able to attract large numbers of tourists.

The second half of 2008 saw a decrease in tourist arrivals and in occupancies for the existing hotel properties. This meant that it was time for the hotel industry to re-evaluate their strategies for the future and to realise that bliss could not continue.

A Wishful Future

The global economic crisis has impacted all segments of tourism and has caused slowdowns in both business and leisure travel to the Emirate. This, combined with the increased levels of new supply changing Dubai's skyline over the first six months of 2008, has caused a significant downturn in the hospitality sector of tourism for the Emirate. This downturn has been exacerbated by the strengthening value of the US dollar against both the euro and the British pound, which has resulted in higher prices for European visitors to the region. Owing to Dubai's dependence on the western countries and specifically the European market, the Emirate has been hit the hardest since the end of 2008 causing a rethinking of strategies for the hospitality market.

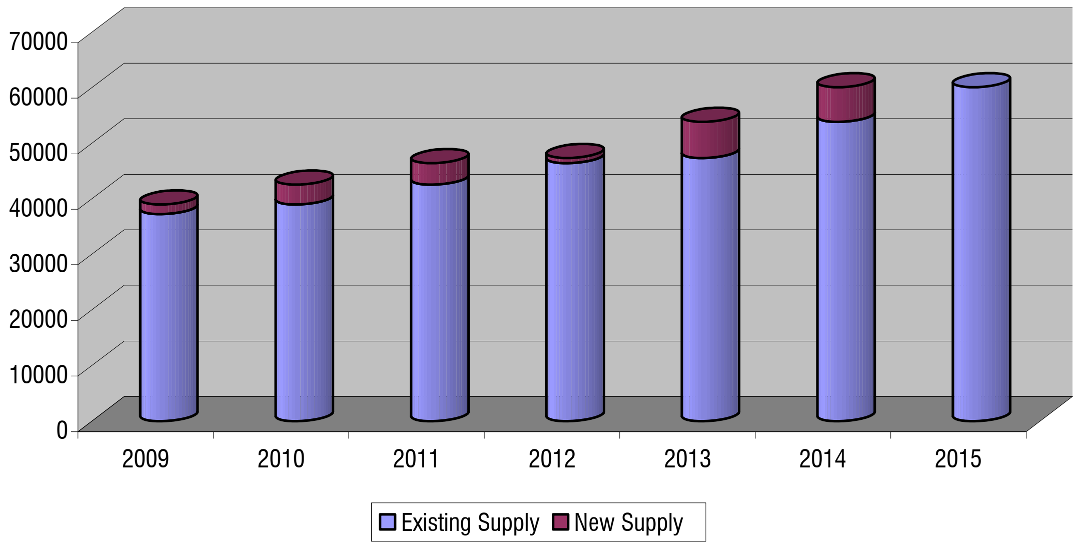
Furthermore, the looming economic crisis and its effect on the Dubai tourism market have caused many of the proposed developments to be cancelled or postponed. It is estimated that 30-40% of construction and real estate projects have been postponed or cancelled since the end of 2008. According to a report published by HSBC at the end of 2008, 60% of the real estate projects in Dubai, collectively worth approximately US$75 billion, were to have been cancelled or delayed. Most of the projects are mixed-use developments and include at least one hotel component. For example, other 'mega' projects, such as The Palm, Deira, have been cancelled and The Palm, Jebel Ali has been put on hold. Most of the projects proposed for the World or the Waterfront have been cancelled or delayed indefinitely owing to the lack of funds available to the individual developers.

The development of the US$790 million Trump Hotel has also been put on hold, and Nakheel has postponed the construction of the Nakheel Harbour and Tower. Other projects which have been delayed are in the very early stages of development and there is strong speculation that these projects will never be completed once the strategy of the city is revised.

Most recently, research indicates that a total of 477 projects or 142,702 rooms are being developed in the Middle East. This represents a fall of 14% and 13%, respectively, from the second quarter of the 2008 peak. Over 53% of the region's total pipeline projects are currently under construction. New hotel openings are expected to accelerate in 2009, 2010 and into 2011, as the large, iconic projects come online. The pipeline in Dubai has 124 projects or 48,558 rooms, representing 34% of all guest room developments in the region. Dubai's average project size is 392 rooms, one of the highest for any country or market worldwide, second only to Las Vegas. One study reports that the UAE has seen a cancellation of 6,500 rooms since the beginning of the year, while another study indicates that in May projects valuing US$26 billion were cancelled or postponed and in April projects worth US$166 billion were either cancelled or delayed. We note, however, that it is very difficult to quantify the changes in development as many projects are not being officially cancelled, but rather delayed.

Although the pipeline of new supply has declined owing to the cancellation and delay of projects at the early stage of their planning, there remains a significant level of committed supply which will enter the market within the next two to three years. We note that the pipeline illustrated in Figure 3 has taken into account delayed projects that are expected to enter the market later than anticipated. Our estimates indicate that Dubai will have a total of 28,214 new hotel rooms by 2015 compared to the expected 80,000 rooms.

Figure 3 Expected Hotel Room Supply 2009-15



Source: HVS Estimates

Although this is a drastic change from what was expected of Dubai, these changes also hold their advantages and will prove to be beneficial in the long-term sustainability of the Emirate. The advantages already perceived in the market range from a reduction in development costs which is helping the completion of many projects and increasing their financial feasibility, in addition to the fact that a rethinking of the proposed new supply has decreased competition in the market and will help avoid cannibalisation. Furthermore, the downturn has proven to be a lesson to the developers and operators in the market in that it has forced them to rethink their strategies and fundamentals and to return to the basic principle of hospitality, 'getting heads in beds'.

Dubai, being one of the region's largest markets and the most developed is quickly responding to the economic slowdown. Although many developers are being forced to postpone construction, the government of Dubai is continuing with their infrastructure and support projects, which will further develop Dubai into a major urban destination. Furthermore, the government is doing its utmost to entice visitation to the Emirate. They are instilling cut rates for the hotels in the market and offering various activities to attract visitation.

Although the emirate is not experiencing the exorbitant levels of profitability it has been for the past five years, research indicates that Dubai is still one of the top performers in the region and is faring well against its other comparable worldwide destinations. According to our research, Dubai's RevPAR has decreased from US$210 in 2008 to US$203 year-to-date in 2009, however they are still performing better than many top destinations around the world, ranking second after Abu Dhabi when compared to 17 destinations worldwide.

Although Dubai has been at the forefront of tourism for the region, the neighbouring countries have begun to develop their offering and have been gaining in competitiveness against Dubai. The infrastructure and support programs in place, as well as the completion of the mega-projects already underway, will allow Dubai to remain competitive. However, the Emirate should be weary to maintain their advantageous positioning in the region.

Challenges and Opportunities

Because of the current changes in market dynamics and worldwide events, which are expected to have an impact on all markets, we have chosen to reflect on the key challenges and opportunities that exist in today's environment.

The global economic crisis, which has affected credit availability and caused decreases in consumer and business travel, resulting in occupancy and room rate declines across Dubai, has also had a serious impact on lodging development. With reduced availability and increased cost of debt, as well as concerns over the sustainability of the market, many investors have become increasingly cautious.

Since the beginning of the second quarter of 2009, debt providers, although they have re-opened their doors, have increased the loan to value ratios, forcing investors to commit to higher levels of equity for acquisitions and developments. In turn, this has caused investors to require higher cash yields from property to maintain equity return levels. This reflects the fact that the perceived risk in the market has increased causing investor caution, a new phenomenon for the Emirate.

Furthermore, as the cost of construction decreases, other overhead costs that were previously at low levels have begun to increase, namely the cost of labour. With India and China continuing to develop, many expatriates working in Dubai for the past five years have chosen to return to their homes to be close to their families and earn a living in the construction field. In addition, as the downturn affected many independent developers in the region, the government has decided to become more stringent with applying barriers to enter into the market. We expect that this will increase consumer and investor confidence in the market, thus re-building Dubai into a newly improved Emirate.

Although investors are remaining cautious, now is the time when 'cash is king'. For those investors who are holding sums of cash and for those who do not have large debts, now is the time to consider investing in the region. Although profitability levels will never return to the high levels experienced in the past, we do consider that in the next two years the economy will recover and Dubai will remain at the forefront of tourism as a regional business and leisure hub. Furthermore, we have noticed a sharp rise in the number of developments in the three-star and four-star categories, which in turn, will widen the target market for the Emirate.

For feasibility studies, valuations, strategic positioning and further advice please contact the authors.

About our Team

HVS has a team of experts that conducts our operations in the Middle East and North Africa. The team benefits from international and local backgrounds, diverse academic and hotel-related experience, in-depth expertise in the hotel markets in the Middle East and a broad exposure to international hotel markets. Over the last three years, the team has advised on more than 150 projects in the region for hotel owners, developers, lenders, investors and operators. HVS has advised on more than US$25 billion worth of hotel real estate in the region.

Natasha Kassam is a Consulting and Valuation Analyst with HVS Dubai. Having started her career at a young age with Sterling Group in Canada, she worked her way up the ladder learning the different aspects of the operations of a hotel. In 2006, after completing a Bachelors of Commerce she decided to pursue her career in hospitality and attended Les Roches School of Hotel Management for her MBA in International Hospitality Finance. Following her studies, Natasha reconnected with Sterling Group in the real estate and acquisitions department and travelled across Africa and the Middle East trying to establish the company's first international hotel. Natasha joined HVS in May 2008 and has since worked on numerous mid and large-scale mixed-use developments and has conducted various feasibility, return on investment and highest and best use studies across the Middle East.

Hala Matar Choufany is the Managing Director of HVS Dubai and is responsible for the firm's valuation and consulting work in the Middle East and North Africa. She initially joined HVS London in 2005 and moved to HVS Shanghai in September 2006 where she helped grow the Shanghai office and business in the Asia region. She relocated to Dubai in September 2007 and looks after HVS interests in the Middle East. Before joining HVS, Hala had four years of operational and managerial hotel industry experience. She lectured at Notre Dame University in Lebanon on International Travel and Tourism. Hala holds an MPhil from Leeds University, UK, an MBA from IMHI (Essec-Cornell) University, Paris, France, and a BA in Hospitality Management from Notre Dame University, Lebanon. Hala has worked on several mid and large-scale mixed-use developments and conducted numerous valuations, feasibility studies, operator search, return on investment and market studies in Europe, the Middle East and Asia.

For further information, please contact one of the authors.

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