

## Changing Times: But For Better or For Worse?

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Hala Matar Choufany

### Introduction and Highlights

The HVS Middle East Hotel Survey for 2009 encompasses 140 hotels (a total of 39,500 rooms). Our sample includes branded four-star and five-star hotels but excludes super-luxury hotels, as they could skew the results of this survey. We have chosen to include in our annual survey only those hotels with an operating history of more than three years; this is to avoid the distortion due to the initial years of a hotel operation.

Using our extensive database of hotel operating results for the Middle East, a database which has been developed with the continued support of all of the major hotel companies in the region, HVS has again prepared a GOPPAR (gross operating profit per available room) analysis for each market, with the exception of Muscat; here, insufficient data were available for our analysis.

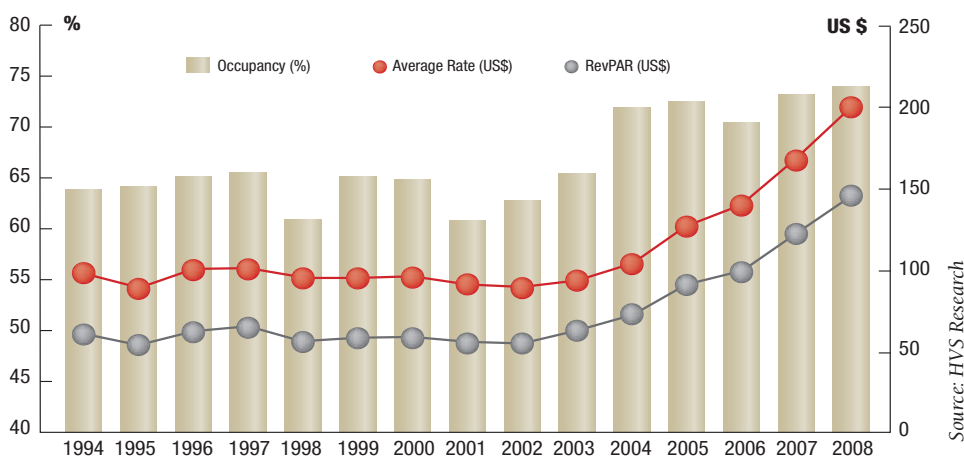
Many questions were raised at the beginning of 2008 about the likely performance of the Middle Eastern cities. Some experts have suggested that there is likely to be some correction in 2008, and others have remained highly confident that the bubble is far from bursting.

HVS has suggested, correctly, that some cities will witness slower growth than others on account of the rapid increase in the number of developments and the risk of an imbalance between supply and demand. We suggested in last year's edition of this survey that certain cities would continue to grow as a result of a shortage of new rooms, improved infrastructure, a more dedicated tourism strategy and enhanced political stability.

We take a closer look in this year's edition at the performance of the key Middle Eastern cities in 2008, analyse the outcome and note the opportunities and threats that lie ahead in the near future, especially in light of the worldwide economic events that are being felt in different degrees by Middle Eastern cities.

We ask the question: 'How did the markets perform in 2008 and what is the likely performance for 2009?'

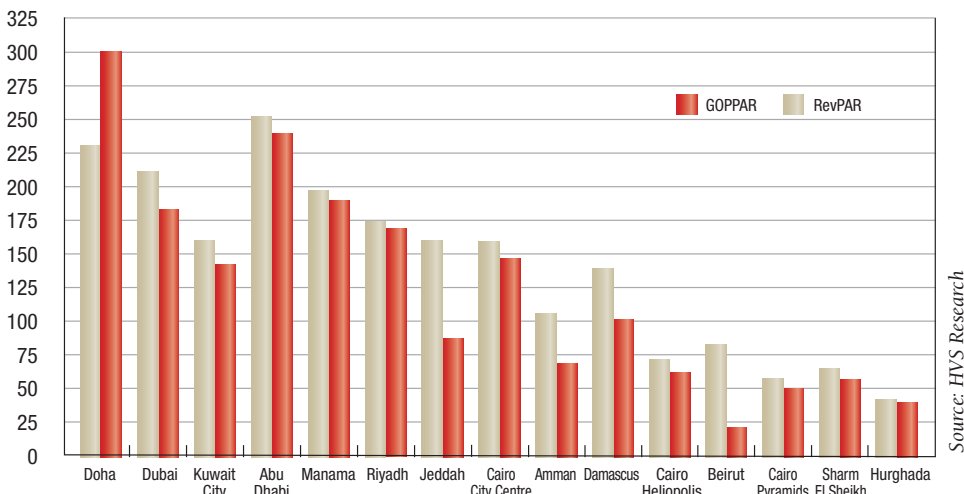
**FIGURE 1 Performance of First Class Hotels in the Middle East 1994-08**



Strong growth in the number of occupied room nights in most cities in the first six months of 2008 suggested that marketwide occupancy would grow by at least four percentage points on 2007. In reality, marketwide occupancy among quality hotels in the region grew conservatively in comparison to 2007 by a mere one percentage point. Even so, the occupancy of 74% was unprecedented. Although this increase in occupancy suggests an increase in visitation to the region (visitation is discussed later), we note that not all markets grew in 2008: some cities either stagnated or saw a decline in occupancy in comparison to 2007.

The modest increase in occupancy notwithstanding, average rate across the region once again increased significantly, by approximately 18% (slightly lower than the 21% registered in 2007) from US\$168 in 2007 to US\$197 in 2008. The resultant RevPAR (rooms revenue per available room) of US\$146 was up 20% on 2007 and compares to growth of 24% in 2007, 9% in 2006 and 23% in 2005. In line with the relatively strong growth in RevPAR, hotels' gross operating profit rose by 12% on average. GOPPAR increased from US\$111 in 2007 to US\$124 in 2008. This clearly reflects the fact that GOPPAR is driven predominately by RevPAR.

**FIGURE 2 RevPAR vs GOPPAR Trends 2008 (US\$)**



**Occupancy**

In contrast to 2007 when most cities saw strong growth in occupancy, 2008 proved to be more challenging for certain markets for the following reasons: increased competition among neighbouring cities; an increase in the number of hotel rooms; the entry of more budget hotels, which took business away from four-star and five-star hotels in the market; and the slowdown in international travel in the last quarter of 2008.

The market worst hit in 2008 was Cairo (Heliopolis), which saw a decline in occupancy of 13 percentage points). Dubai saw a decline of seven percentage points), Doha four percentage points and Manama two percentage points. Sharm El Sheikh, Jeddah, Riyadh and Kuwait City witnessed occupancy growth of five, four, and three percentage points, respectively. Beirut saw a phenomenal increase of 17 percentage points on 2007. It is worth noting that after the drop in occupancy in Beirut in 2007 and in the first half of 2008, falls due largely to political instability in the region, hotels in Beirut were able to achieve occupancy of approximately 75-80% on average over the remaining six months of 2008. This resulted in an annual occupancy of 57% in 2008 compared to 39% in 2007.

Hotel occupancy in Muscat increased by two percentage points, largely on account of the closure of the Al Bustan Hotel and Sheraton for a full refurbishment in 2008.

Occupancy in all other markets in our survey remained relatively stagnant on 2007 levels, with less than one percentage dip or increase in occupancy.

**Average Rate**

Increased regional and international travel in the first six months of 2008, coupled with the opening of five-star and luxury hotels in some of the cities, had a positive impact on average rate. All of the cities in the survey saw average rate increase by more than 18% in 2008; only Dubai and Cairo (Heliopolis) saw their average rate stagnate.

In line with the increase in occupancy among city hotels in Beirut in the last six months of 2008, citywide average rate increased by 91%, from US\$78 in 2007 to US\$148. Sharm El Sheikh and Damascus too both witnessed a significant increase in average rate: 54% and 48%, respectively. It is worth noting that Sharm El Sheikh has, historically, achieved very low rates; they averaged around US\$45 between 1994 and 2007.

For a second consecutive year, average rate in

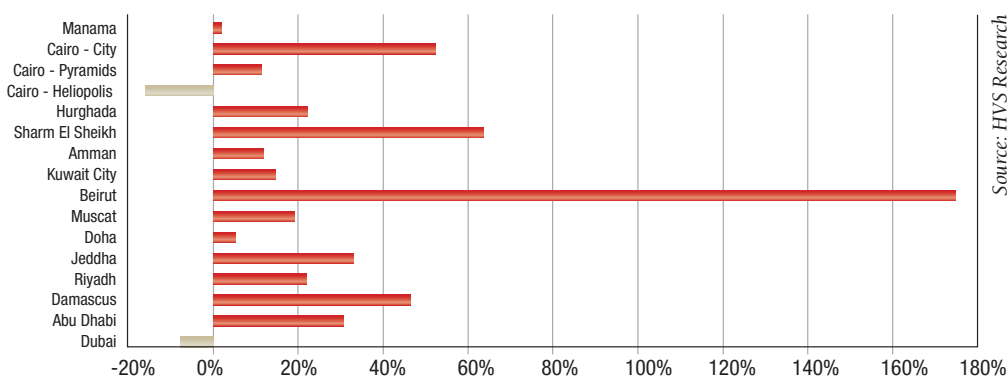
Abu Dhabi increased: by 30%, from US\$238 to US\$309. This compares to growth of 42% between 2006 and 2007. It is worth noting that in 2008 for the first time since 1996 average rate in Abu Dhabi surpassed that in Dubai. Average rate in Dubai was only US\$261 in 2008 compared to US\$258 in 2007.

On account of an increase in demand in Saudi Arabia and the limited amount of new supply in 2008, both Riyadh and Jeddah recorded an increase in average rate of in excess of 15%.

After recording average rate growth of approximately 38% in 2007, Cairo (City Centre) saw average rate grow by 17% in 2008, from US\$137 to US\$160, largely on account of the rate growth caused by the establishment of five-star and luxury hotels in the market.

We note that the hotel markets in Bahrain, Oman and Kuwait City still operate under an owners' cartel agreement.

**FIGURE 3** Winners and Losers – Percentage Change in RevPAR in 2008



**RevPAR and GOPPAR**

Largely on account of a strong growth in average rate, all but two cities in the Middle East saw a significant increase in RevPAR in 2008. At the forefront was Beirut, which saw RevPAR growth of 175%. Sharm El Sheikh saw growth of 64%, Cairo City 53% and Damascus 47%.

As a result of stagnating average rate, hotels in Dubai saw their RevPAR decline by 7%. RevPAR in Cairo (Heliopolis) declined by 15%.

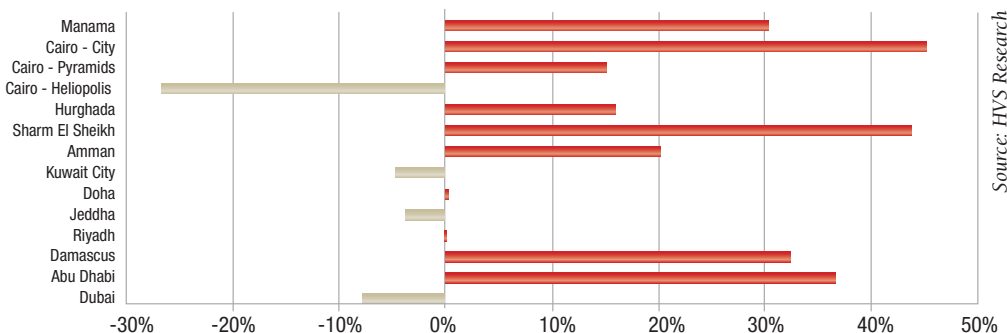
With the exception of Beirut, which saw an increase in GOPPAR of 699%, from US\$3 to US\$24, Cairo (City Centre) and Sharm El Sheikh were the clear winners in 2008 with an increase of approximately 45%. We excluded Beirut from Figure 4 as this city would have skewed the presentation of the individual cities. As it had in previous years, GOPPAR in Manama, Damascus and Abu Dhabi grew by around 30%. Owing to the drop in occupancy and stagnating average rate, Cairo (Heliopolis) saw GOPPAR decline by 26%.

For the first time in our survey Dubai saw GOPPAR decline, by 7%. GOPPAR in Kuwait City and Jeddah dropped by 4% and 3%, respectively.

As it did in 2007, Doha recorded the highest GOPPAR, which in 2008 was US\$299. Abu

Dhabi recorded the second-highest GOPPAR: of US\$240. Despite the growth in both occupancy and average rate in Beirut, the hotel market there recorded the lowest GOPPAR, of US\$24, with the second-lowest being Hurghada's US\$40.

**FIGURE 4** Winners and Losers – Percentage Change in GOPPAR in 2008



As discussed in last year's survey, despite our generally positive outlook for the Middle Eastern markets, we projected that market correction was likely to start in certain cities, notably in those that had experienced large increases in visitation and a significant increase in room supply.

As we close the book on 2008, we expect occupancy and average rate in most of the markets in our survey to decline over the next two years on account of, primarily, economic slowdown; increased competition among hotels and among cities; and further additions to supply, which will allow for a healthier relationship between supply and demand as new supply is absorbed into the market.

We foresee Riyadh, Doha, Beirut, Damascus and Cairo (City Centre) faring better than the other cities in our survey in 2009.

In view of the dependency of the Dubai, Cairo

(Pyramids), Hurghada, Sharm El Sheikh and Muscat markets on the international leisure market, we envisage these markets witnessing a decline in visitation over the course of 2009 and into 2010 as a result of the expected significant slowdown in international travel.

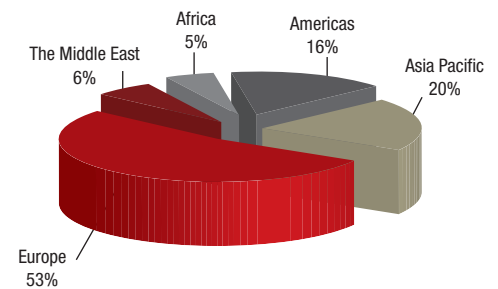
### What are the Trends?

According to figures from the World Tourism Organization (WTO), the number of tourist arrivals worldwide grew by only 1.8% between 2007 and 2008. The same figures showed that growth in the Middle East was 11.4%, once again reflecting the potential for tourism growth in the region.

FIGURE 5 Worldwide Tourism Trends and Distribution 2005-08

	Tourist Arrivals (Millions)				% Change 2007-08
	2005	2006	2007	2008	
<b>World</b>	<b>806,0</b>	<b>846,0</b>	<b>908,0</b>	<b>924,0</b>	<b>1,8</b>
Africa	37,3	40,3	44,9	46,9	4,5
Americas	133,5	136,3	142,5	147,6	3,6
Asia Pacific	155,4	167,1	185,4	188,3	1,6
Europe	441,0	460,8	488,0	488,5	0,1
<b>The Middle East</b>	<b>39,2</b>	<b>41,0</b>	<b>47,5</b>	<b>52,9</b>	<b>11,4</b>

Source: WTO



Although intra-regional Arab visitation still accounts for a large proportion of the number of tourists in the region, arrivals from Europe, America and Asia in the Middle East has grown significantly over the last three years. Markets that have enjoyed high levels of leisure visitation from these international source markets and that are considered to be vulnerable to any change in travel patterns will find that the year ahead will prove to be quite challenging as a result of the drop in disposable income and a reduction in travel.

It is worth noting that in the last two months of 2008 and the first two months of 2009 that the price of travel and hotel packages was reduced significantly to minimise the effects of the slowdown by offering cheaper travel. Most markets are looking at increasing their share of intra-regional travel to compensate for the expected loss in international travel.

Over the last two years, most of those cities dominated by leisure visitation have begun to make serious efforts to attract a greater proportion of commercial visitation by creating dedicated business hubs in an effort to diversify the tourism product on offer. Cairo has been quite successful in implementing a diversification strategy and so too has Dubai. Despite the annual double-digit increase in the number of tourist arrivals in the Middle East, this segment still accounts for just over 5% of the total number of tourist arrivals worldwide. We expect that over the next five years this

segment will account for approximately 10% of the total number of arrivals worldwide, assuming that recovery starts around the second quarter of 2010.

### Airports and Airlines

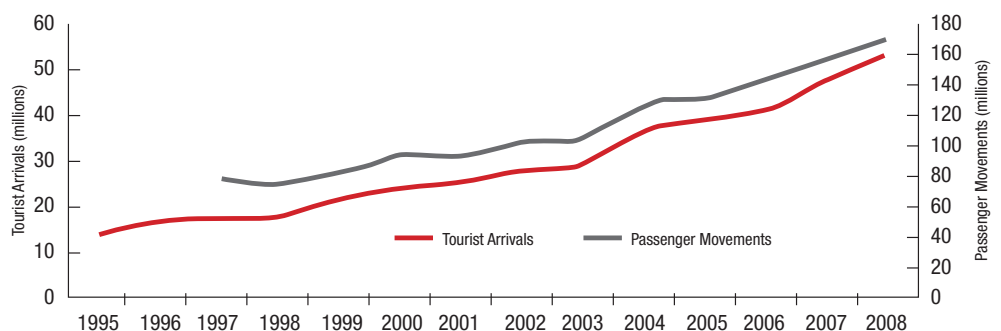
Airport passenger counts are important indicators of hotel demand. We note that trends showing changes in passenger count reflect business activity and the general economic health of an area. As illustrated in Figure 6, trends in tourist arrivals and passenger movements are almost identical; this is further underlined by a correlation coefficient of 0.99.

The International Air Transport Association (IATA) rightly predicted that the growth in the number of international passenger would slow slightly in

2008 in comparison to 2006 and 2007. In 2008, the number of international tourist arrivals grew by 10%, from 48 million to 52.9 million, in contrast to growth of 17% between 2006 and 2007. The number of airport passenger movements grew by 7% over the same period, from 158 million to 169 million. This slowdown in growth is attributable largely to the slowdown in international travel in the final quarter of 2008.

We expect that this growth will fall further in 2009 despite the increase in routes announced by prominent Middle Eastern carriers such as Emirates, Qatar Airways and Etihad in 2008. We note that all three carriers purchased new fleets in 2008, increased the number of daily and weekly flights to Europe, Asia and the Americas and opened up new routes in a bid to entice new markets to the region.

FIGURE 6 Middle East Tourism Arrivals and Airport Passenger Movements 1995-08



Sources: WTO Estimates; Airports Council International

As a result of the decline in traffic from international source markets coming to the Middle East and in an effort to reduce costs, Emirates recently announced that it would no longer be using the A380 on its daily Dubai-New York route; the extra seats were unnecessary on account of a fall in the number of passengers. Emirates reduced its services to China on account of falling load factors. Other airlines have made similar announcements.

Airport expansion and construction projects are ongoing in most cities in the Middle East in order to accommodate the projected increase in the number of tourist arrivals over the next ten years. Such projects, although still on track, have been delayed slightly. Cairo's new airport is nearing completion and it is expected to be operational in 2009. Terminal 3 at Dubai airport opened in the final quarter of 2008.

Low-cost carriers such as Jazeera Airways and Air Arabia have successfully established a presence in the region. FlyDubai, Emirates' low-cost carrier, is expected to start operations by the middle of 2009 and it will serve those destinations that are within one to four hours' flying time from Dubai. Such destinations will include the Indian subcontinent, North

and East Africa, southeast Europe and other areas of the Middle East.

Additionally both low cost national carriers, National Air Services (NAS), the Kingdom's first

private airline, and SAMA have announced plans to increase their routes and fleet to all major Middle Eastern cities as well as Southeast Asia.

FIGURE 7 Growth in Airport Passenger Movements



Sources: WTO Estimates; Airports Council International

Despite today's challenging market conditions, we remain confident that the planned improvements and infrastructure work in the Middle East are much needed in order to

further enhance the attractiveness of the region. We consider that these projects will have a considerable positive impact on the future level of visitation to the region.

## Hotel Performance and Investment

Figures 8, 9 and 10 illustrate, respectively, average annual occupancy, average rate and RevPAR from 1994 to 2008 for the different markets that we cover in the Middle East Hotel Survey.

FIGURE 8 Average Annual Occupancy 1994-08

		1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	Average
Bahrain	Manama	65%	58%	53%	63%	58%	56%	59%	62%	64%	64%	72%	75%	71%	77%	75%	65%
Egypt	Cairo – City Centre	—	67	73	75	69	79	78	66	68	67	78	79	77	76	75	74
	Cairo – Pyramids	—	58	66	66	47	70	76	61	62	61	73	76	75	80	86	68
	Cairo – Heliopolis	—	65	79	72	70	83	83	75	75	73	75	77	74	86	67	75
	Hurghada	48	63	70	63	50	80	77	65	66	66	86	75	75	86	88	70
	Sharm El Sheikh	79	73	72	66	68	79	63	61	66	64	75	71	66	76	81	71
Jordan	Amman	61	74	71	61	56	56	59	44	45	57	72	70	58	64	66	61
Kuwait	Kuwait City	44	41	44	46	46	47	46	49	53	84	64	70	65	58	62	55
Lebanon	Beirut	—	—	45	61	61	56	57	55	57	59	71	52	48	39	57	55
Oman	Muscat	67	66	64	71	56	57	55	62	59	57	69	80	74	67	69	65
Qatar	Doha	61	75	80	78	72	61	58	56	60	72	72	71	71	71	68	68
	Doha	61	75	80	78	72	61	58	56	60	72	72	71	71	71	68	68
Saudi Arabia	Jeddah	68	64	61	58	60	59	63	59	57	53	54	61	64	73	77	62
	Riyadh	66	62	61	62	63	62	60	61	65	64	55	62	70	71	74	64
Syria	Damascus	70	73	68	70	69	69	66	65	67	65	69	75	73	80	79	70
UAE	Abu Dhabi	65	58	66	65	66	64	67	67	68	68	82	85	84	81	81	71
	Dubai	74	69	74	73	70	70	74	71	76	79	86	82	84	87	81	77
<b>Average</b>		<b>64%</b>	<b>64%</b>	<b>65%</b>	<b>66%</b>	<b>61%</b>	<b>66%</b>	<b>65%</b>	<b>61%</b>	<b>63%</b>	<b>66%</b>	<b>72%</b>	<b>73%</b>	<b>71%</b>	<b>73%</b>	<b>74%</b>	<b>67%</b>

Source: HVS Research

FIGURE 9 Average Rate 1994-08 (US\$)

		1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	% Change 2007-08	Compound Annual Growth Rate 1994-08
Bahrain	Manama	86	87	92	90	93	102	105	103	119	122	132	177	196	249	262	5%	8%
Egypt	Cairo City Centre	—	73	72	78	78	80	86	85	77	75	75	87	99	137	160	17	6
	Cairo Pyramids	—	38	42	46	44	47	59	60	36	38	42	46	49	61	68	12	5
	Cairo Heliopolis	—	59	62	61	62	62	68	65	59	60	63	67	77	107	108	1	5
	Hurghada	67	39	41	44	30	34	41	35	30	32	40	47	46	41	49	19	-2
	Sharm El Sheikh	51	49	53	52	35	44	45	41	37	39	42	52	54	53	81	54	3
Jordan	Amman	67	75	83	83	81	71	68	68	65	69	85	118	132	147	161	10	6
Kuwait	Kuwait City	209	205	213	201	204	203	214	218	216	233	230	237	239	239	260	9	2
Lebanon	Beirut	—	—	166	173	143	129	110	101	110	154	168	116	110	78	148	91	-1
Oman	Muscat	103	103	112	101	95	91	86	80	74	66	82	117	154	283	329	16	9
Qatar	Doha	65	68	77	101	116	112	115	105	100	101	146	268	296	306	340	11	13
Saudi Arabia	Jeddah	99	103	117	115	113	111	119	110	104	104	114	144	137	165	208	26	5
	Riyadh	98	105	106	110	113	116	115	110	107	104	105	110	142	202	236	17	7
Syria	Damascus	102	73	124	118	111	104	97	94	94	102	100	105	95	120	178	48	4
UAE	Abu Dhabi	108	114	129	111	101	99	88	89	89	87	91	117	167	238	309	30	8
	Dubai	117	119	120	126	107	104	105	100	110	113	144	192	225	258	261	1	6
Average		98	87	101	101	95	94	95	92	89	94	104	125	139	168	197	18%	5%

Source: HVS Research

FIGURE 10 RevPAR Performance 1994-08 (US\$)

		1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	% Change 2007-08	Compound Annual Growth Rate 1994-08
Bahrain	Manama	56	51	49	56	54	57	62	64	76	78	95	133	140	193	197	2%	9%
Egypt	Cairo City Centre	—	49	53	58	54	63	67	56	52	50	59	69	77	105	160	53	9
	Cairo Pyramids	—	22	28	30	20	33	45	37	22	23	31	35	37	52	58	12	8
	Cairo Heliopolis	—	38	49	44	43	52	57	49	44	44	47	52	57	85	72	-15	5
	Hurghada	32	24	29	28	15	27	31	23	20	21	34	35	34	35	43	22	2
	Sharm El Sheikh	40	36	38	34	24	35	28	25	24	25	32	37	36	40	66	64	4
Jordan	Amman	41	55	59	51	45	40	40	30	29	39	61	82	77	95	106	12	7
Kuwait	Kuwait City	93	83	93	93	94	94	98	107	114	196	147	165	155	139	160	15	4
Lebanon	Beirut	—	—	75	105	88	73	62	56	63	91	119	61	53	30	84	175	1
Oman	Muscat	69	68	71	72	53	52	47	50	44	38	57	94	114	190	227	19	9
Qatar	Doha	39	51	62	79	83	69	67	59	60	73	105	191	208	218	230	5	13
Saudi Arabia	Jeddah	67	66	71	67	68	66	75	65	59	55	62	88	87	121	161	33	6
	Riyadh	65	66	64	69	71	72	69	67	70	67	58	68	100	143	174	22	7
Syria	Damascus	71	53	84	82	76	72	65	61	63	66	69	79	69	95	140	47	5
UAE	Abu Dhabi	70	66	85	72	66	63	60	60	61	59	75	99	140	192	252	31	10
	Dubai	87	82	89	92	75	73	78	71	84	89	124	158	188	225	210	-7	7
Average		61	54	62	65	58	59	59	55	55	63	73	90	98	122	146	20%	6%

Source: HVS Research

### New Supply

Using our knowledge of the current market conditions, cancellations announced and the status of projections under construction, HVS estimates that no more than 83,000 rooms (rooms in projects confirmed) will be entering the Middle East and Egyptian markets over the next five years. Last year, it was announced that 155,000 rooms would be entering those markets. Less than 10% of the projects announced in last year's article entered the market in 2008: a total of approximately 9,000 rooms across ten countries.

According to a report published by HSBC, 60% of the real estate projects in Dubai, together worth approximately US\$75 billion, are to be cancelled or delayed. Most of these projects are mixed-use developments and include at least one hotel component. The Dubailand development, for example, which includes the Falcon City of Wonders, originally planned to have replicas of the Eiffel Tower, the Taj Mahal and the Leaning Tower of Pisa among others.

Other 'mega' projects, such as The Palm, Deira, have been cancelled and The Palm, Jebel Ali has been put on hold. Most of the developments proposed for The World and The Waterfront have been cancelled.

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 across the United Arab Emirates (UAE) have either been cancelled or been put on hold.

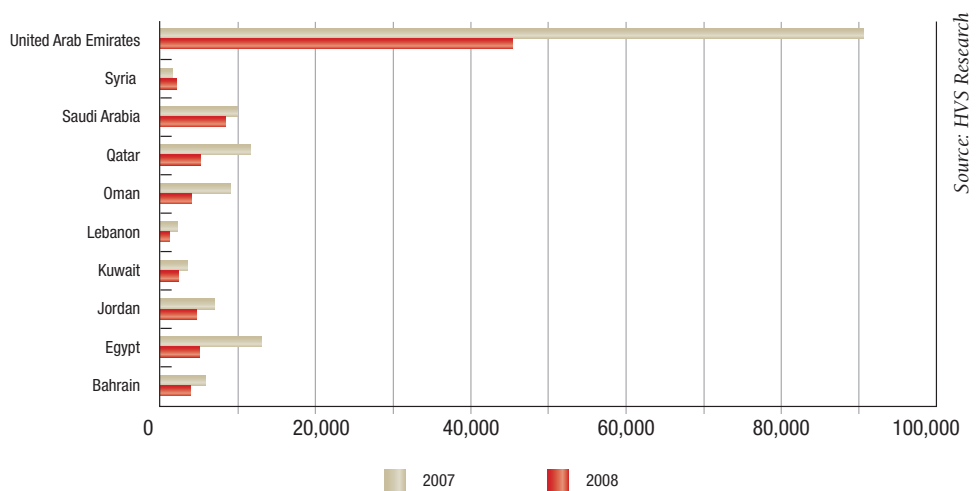
As for the rest of the cities in the Middle East, although projects have not been officially announced as having been cancelled, some projects have been put on hold and opening dates have been pushed back indefinitely.

Nevertheless, despite the cancellation of projects in Dubai, 54% of the hotel projects announced

as confirmed are planned for the UAE market, notably in Abu Dhabi and Dubai.

At the time we wrote this article, only 8,400 rooms in Riyadh and elsewhere in Saudi Arabia had been confirmed. However, we consider that in the near future the Riyadh market is likely to see almost double the number of rooms already announced, as many hotel projects will be announced in the course of 2009 and 2010, specifically those in proposed new cities such as King Abdallah Financial District.

**FIGURE 11 New Supply by Country (Rooms) 2007 vs 2008**



The operators in the region most active in the expansion of their brands are Rotana (12,300 rooms), Accor (9,600), Marriott (9,000), Mövenpick Hotels and Resorts (8,500), Rezidor (6,000), InterContinental Hotels Group (5,800), Starwood (5,400) and Hilton (4,000). Kempinski and Fairmont both have approximately 3,500 rooms in the pipeline, and Jumeirah some 3,000.

**FIGURE 12 Operators Most Active in Terms of Brand Expansion**

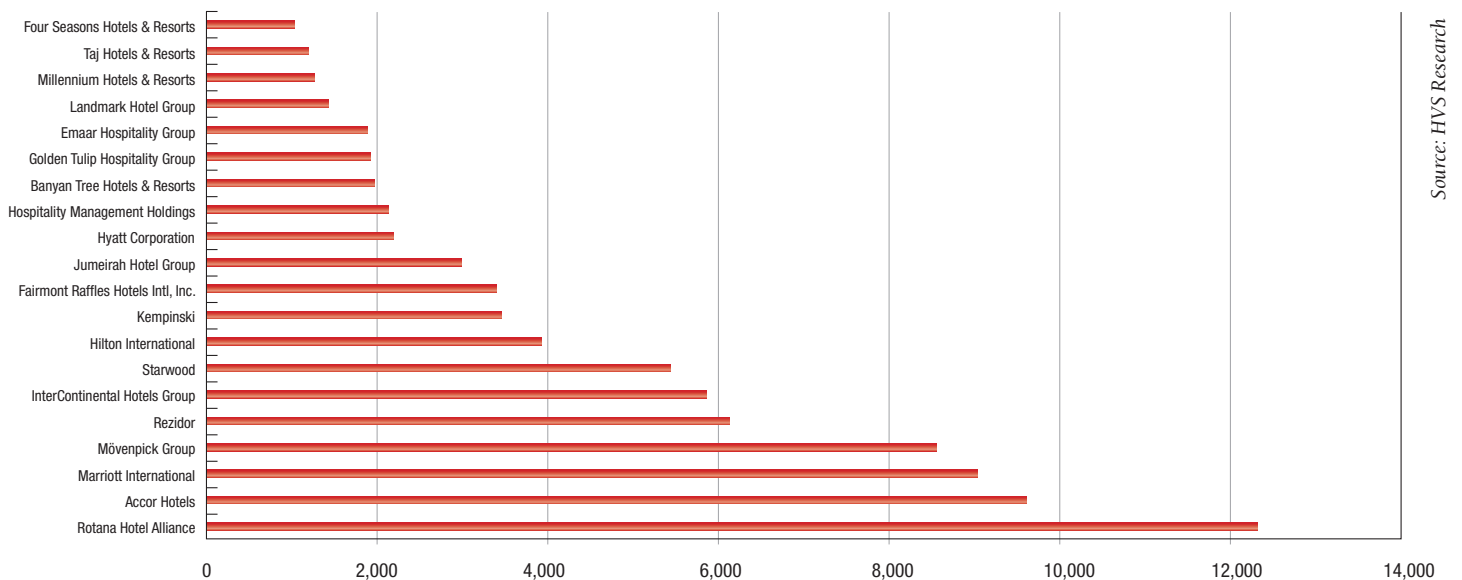
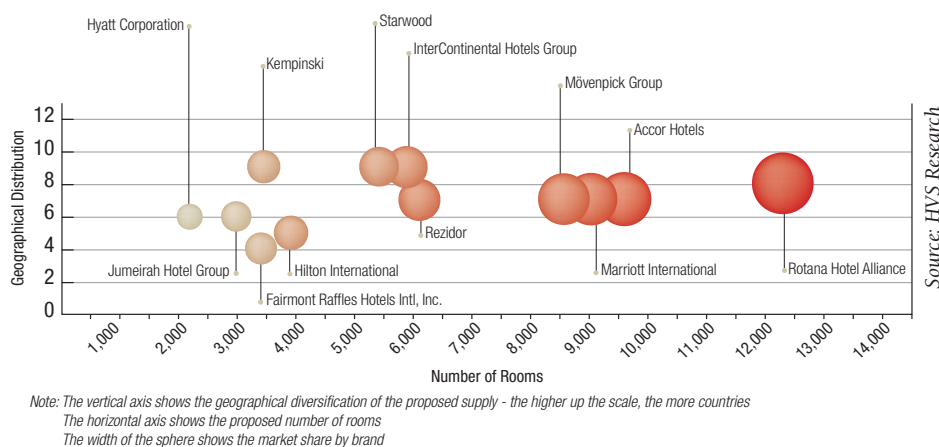


Figure 13 illustrates the geographical distribution of the most active operators in the Middle East. Rotana, with some 12,300 rooms, has announced developments in eight cities in the Middle East. InterContinental Hotels Group, Starwood and Kempinski have plans for nine markets, and Accor, Marriott, Mövenpick and Rezidor plan to expand across seven cities.

Other recently active players, such as Jumeirah and the newly established Emaar Hospitality Group, have announced plans for the development/management of hotels in six Middle Eastern cities. Emaar announced in 2008 the launch of The Address brand and opened the first property with that brand in Burj Dubai, in October 2008.

**FIGURE 13 Operators Most Active in Terms of City Expansion**



## 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 following list is by no means exhaustive and is instead a summary of some of the key considerations regarding the development, investment in and operation of hotels in the Middle East.

### Challenges Investment and Development

- Although a Middle Eastern investor's sentiment and financing structure was quite different a few years ago from his European counterpart's, today, given the prevailing environment, both types of investor are demonstrating the same caution and putting the same restriction on investment. Both now require the high returns associated with the high risks involved in the development of and investment in hotel operations;
- Access to debt financing is quite scarce at the moment and there are no signs of any early change in this regard. Equity investors are more sceptical than ever and are cautious: waiting before undertaking any investment;
- Although hotel financing in the region has become more aggressive in the last two years, recent indications show a trend towards a greater conservativeness in aspects including mortgage lending ratios, mortgage amortisation periods and debt-servicing structure;
- Although public spending, as opposed to private spending, continues to drive most of the economic and tourism developments in the countries of the Gulf Cooperation Council,

liquidity in both the public and the private equity markets in the region has decreased; and, as a result, several projects that were likely to have induced additional demand into the respective markets over the next two to five years will be delayed or cancelled. The implications will be certainly obvious in the potential number and type of tourist attracted to each destination;

- Completion of projects currently under development will be challenging, especially in the absence of the funding necessary to complete these projects. A greater number of partially completed buildings or just the core and shell of buildings will be noticeable across the major cities as they await being bought or the arrival of better economic conditions;
- An aggressive pipeline of five-star hotels is planned in most of the markets in our survey and there is a high risk of oversupplying the market with this asset class.

### Opportunities Investment and Development

- The lower development costs arising from a drop the price of raw material and contracting costs. Projects that were classed as being somewhat unfeasible in the past have a higher chance of success as a result of this reduction in development costs;
- The increasing number of distressed assets presents the greatest opportunities yet for investors to acquire long-sought-after assets at higher yields;
- Inflation in most cities in the Middle East is expected to decrease and adjust, hence providing lower contracting and developing costs and improving the cost of living;
- Investors and owners, and hotel operators in particular, may view this temporary reduction

in demand as much needed breathing space that can be used to engage in activities that are peculiar to pre-opening periods and that are seldom replicated once the establishment opens for business. This crisis period is an ideal time in which to renovate, refurbish, convert, add or modify facilities, although some may argue that during these times cash is king and that holding on to it is paramount;

- Equally, developers may be presented with great opportunities for conversion in response to the greater risk of oversupply in certain asset classes and the opportunity for the development of an alternative product;
- It has been announced that several projects, most notably in Dubai, are either on hold or have been cancelled. Although some might perceive this as negative and a sign of deep recession, others might see such cancellations giving a healthier competitive market once the market recovers, especially as there was a high risk of oversupply in certain markets despite the expected increase in visitation;
- The increased development of hotel derivatives is noticeable. Such asset classes include condominiums, timeshare, serviced apartments and limited service hotels. Although opportunities for investment in such asset classes exist in some parts of the region, we recommend that investors fully understand the market opportunities and investment characteristics of each type of asset class before setting their investment strategies.

### Challenges – Operational

- Most currencies in the Middle East region are pegged to the US dollar and, given the recent depreciation of the euro and sterling, the region is becoming less attractive, in terms of purchasing power, to European leisure markets;

- Increased bans on travel implemented by multinational companies will result in less travel to the region, which, in turn, will affect the profitability of a hotel operation;
- Most cities in the Middle East have been quite dependent on the European and US leisure markets. These markets are unlikely to travel in 2009 or in the first quarter of 2010;
- As a result of an expected slowdown in leisure business and in meetings, incentives, conferences and exhibitions (MICE) business, and the restrictions on travel budgets imposed by corporate business, both occupancy and average rate in most cities are under threat of decline. Hoteliers may find maintaining RevPAR in 2009 to be quite challenging; this will have a great impact on GOPPAR and on the profitability of the operation;
- Despite the cost-reduction techniques that most hoteliers have started to implement – reductions in staff and marketing as well as reductions in fixed expenses – profitability is

likely to be hit by an expected reduction in both occupancy and average rate in most cities in the Middle East;

- As a result of the expected reduction in the number of bookings at hotels, hoteliers are reverting to discounting rates rather tactical pricing to stimulate demand. Hoteliers are chasing the same pool of guests and this is making competition quite fierce and lowering RevPAR;
- Maintaining a high standard of service while employee morale is down on account of downsizing and a reduction in business may have an impact on the level of service provided to guests;
- Tension between hotel owners and operators may arise on account of the expected decline in hotel performance.

### Opportunities – Operational

- It has in the past proved challenging to attract sufficient numbers of skilled workers to the

enormous quantity of developments in the Middle East. With many projects currently cancelled or on hold, greater opportunities exist to find appropriate workers to see the work through to completion or to operate the developments. As a result of the most recent redundancies, an increasing number of skilled labourers are on the hunt for a job;

- At a time of slowing demand, there are greater opportunities for hoteliers to invest in training their employees, especially in markets that have experienced a lag in service on account of the high level of demand that has left little time for training;
- What will differentiate operators in the future is the level of service extended in these difficult times. A focus on customer service and guest retention should be at the forefront of any management strategy;
- Tactical pricing such as 'book two nights, get the third night half-price' rather than discounting would enable hotels to increase occupancy.

## Conclusion

Despite the expected slowdown in international travel and tourism expenditure across the globe, the Middle East, when compared to continents such as Europe and North America, still demonstrates higher levels of economic growth. This growth is driven primarily by the development projects, the expected increase in intra-regional travel, the greater opportunities for work, higher disposable incomes and organic

growth in each of the markets in our survey. Markets such as Abu Dhabi, Saudi Arabia, Kuwait and Qatar have solid sovereign wealth funds and remain dedicated to public spending and enhancing the attractiveness of their countries. Although tourism-related travel is expected to slow, this growth will nevertheless remain high in comparison to that in other parts of the world. We remain confident that the Middle Eastern

markets are still far from reaching maturity and still present great opportunities for investment, largely on account of the natural population growth in demand in the region, and because of the respective government's dedication in transforming their cities into prime business and leisure destinations. Therefore, although some markets will undergo correction during these times, we expect all markets to emerge stronger once the global crisis is over.

## About HVS

*Having been your true partner across the globe for more than 25 years, HVS remains committed to providing you with the most appropriate investment advice and to assisting you in determining the optimal development and investment projects during these challenging times. For strategic advice, management reviews, feasibility studies, valuations, investments and further advice please contact the author.*

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.

**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 joined HVS London in 2005 and moved to HVS Shanghai in September 2006 where she helped grow the office and its business in the Asia region. She relocated to Dubai in September 2007 and looks after HVS's interests in the Middle East. Before joining HVS, Hala had four years' 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 midscale and large-scale mixed-use developments, has provided high-level strategic advice, and has conducted numerous valuations, feasibility studies, operator searches, return on investment analyses and market studies in Europe, the Middle East and Asia.

→ For further information, please contact:



**Hala Matar Choufany**  
Managing Director, HVS Dubai  
Email: [hchoufany@hvs.com](mailto:hchoufany@hvs.com)  
Direct Line: +971 50 4597930

Or visit our website at [www.hvs.com](http://www.hvs.com)