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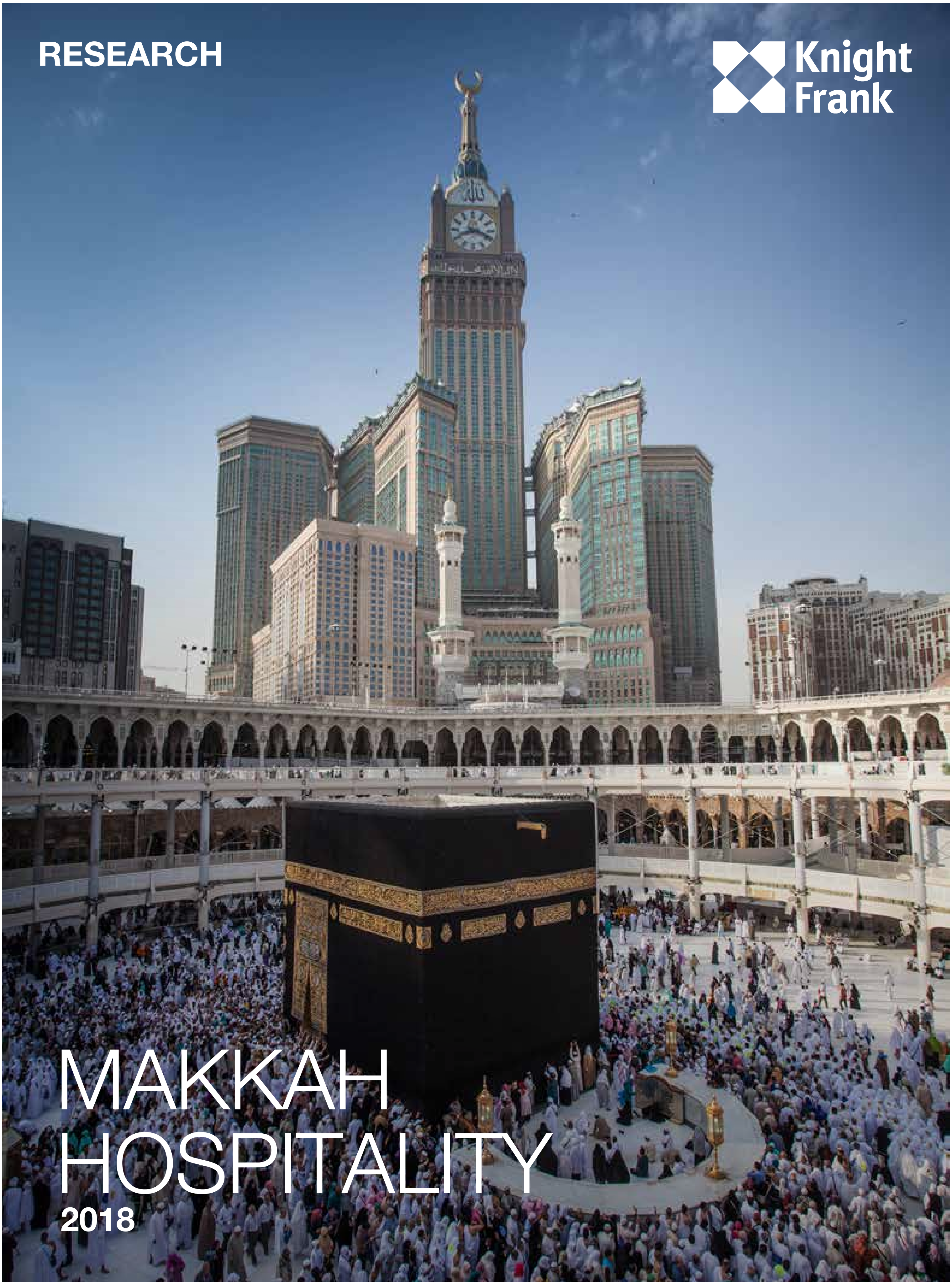


MAKKAH HOSPITALITY
2018

A REVIEW OF THE HOSPITALITY SECTOR IN THE HOLY CITY OF MAKKAH

Key findings

Performance in Makkah's hotel market has been softening in recent years due to both demand and supply side factors. We expect market-wide performance to face continued pressure in the short-term, although hotels in primary locations will prove to be more resilient.

The market is dominated by locally-branded supply in secondary locations. Many of these properties operate for the Ramadan and Hajj periods, and close their doors for the rest of the year.

The opening of the Haramain High Speed Railway and significant progress with the enhancement works at King Abdulaziz International airport are strong signals that the infrastructure is catching up to governmental ambitions for the city, but ultimately legislative and financial constraints still need to be fine-tuned in order to fully maximise the potential of inbound visitation.

ALI MANZOOR
Partner, Hospitality & Leisure

"As large infrastructure projects reach completion, the traditional demand-side bottlenecks related to capacity constraints will be alleviated allowing for increased visitation and revenue inflows, which will ultimately uplift hotel values in the medium to long term."

Please refer to the important notice at the end of this report.

This paper provides a review of the hospitality sector in Makkah and analyses how the market's fundamentals are anticipated to change over the coming years in light of the wide-ranging initiatives, national reform programs and infrastructure projects set to be delivered in the short to medium term.

While most hospitality markets in the GCC are driven by traditional demand-supply mechanics, Makkah – for which religious visitation makes up the majority of demand – works slightly differently, with government quotas and capacity constraints determining tourist flows. In terms of Hajj visitation, although a variety of factors such as health concerns, capacity restrictions and the geopolitical climate have affected tourist numbers between 2013 and 2016, the past two years have been far more positive. During this period, Hajj visitation exceeded the 2.3 million mark in consecutive years for the first time since 2012.

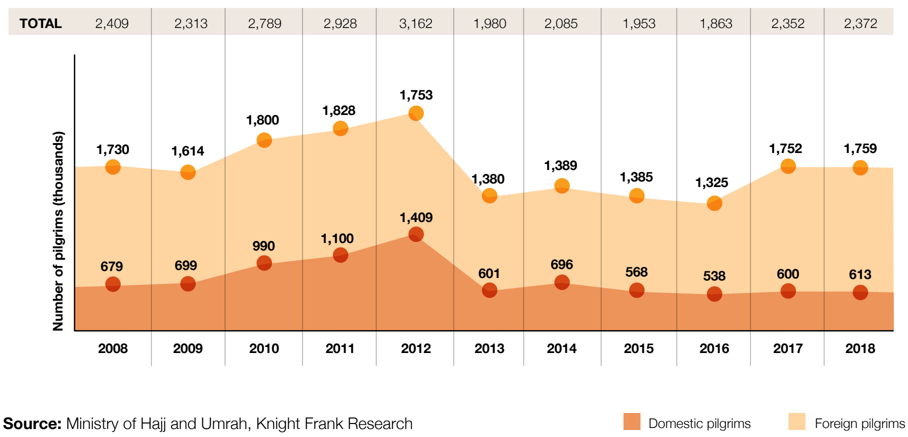
Unlike Hajj, which occurs over a condensed timeframe, Umrah occurs throughout the majority of the year (with the exception of certain blackout months) and as a result, Umrah visitation is not as susceptible to capacity and infrastructure constraints as Hajj visitation. This is evident from the fact that there have been five consecutive years of increasing Umrah pilgrim flows whereas Hajj numbers have been more volatile.

In order to facilitate religious tourist inflows, there have been longstanding plans to upgrade the existing infrastructure. While most are still under development, the most recent of these to come to market is the Haramain High Speed Railway which was inaugurated in September 2018. Connecting Makkah, Jeddah, King Abdulaziz International Airport, King Abdullah Economic City and Madinah, the 450 km line will improve travel times within the Western Region once fully operational, and help to alleviate the capacity constraints of Makkah. Initiatives such as these are a positive signal that the government is investing in the infrastructure required to facilitate the goal of increasing visitor quotas from approximately 10 million as they are today, to 15 million in 2020 and 30 million in 2030.

Hajj 2018

Hajj visitation in 2018 was broadly in line with previous years in terms of source markets, with pilgrims from Asia representing the largest proportion of demand. While Indonesia, Pakistan, India and Bangladesh are typically the largest source markets during Hajj in terms of volume, in general terms religious guests from these nations also tend to be amongst the most price sensitive. Domestic pilgrims accounted for 26% of overall visitation during Hajj of which 35% were Saudi nationals. Non-Saudi domestic visitation was primarily driven by Egypt, Pakistan, India and Yemen.

FIGURE 1
Evolution of Hajj pilgrims, 2008-2018



Source: Ministry of Hajj and Umrah, Knight Frank Research

As the city of Makkah does not have its own international airport, inbound visitors predominantly travel through King Abdulaziz International Airport in Jeddah, and complete the remaining part of the journey by land. As a consequence, the role that the airport plays in facilitating inbound religious travel is crucial, particularly given the seasonal nature of Hajj visitation which occurs over a five day period.

Hospitality Supply

The hospitality supply across Makkah is dominated by low quality, standalone properties as highlighted by numbers published by the Saudi Commission for Tourism and National Heritage (SCTH) which indicate that 50% of the total room supply is classified two star or below. While official records indicate that there are 264,000 hotel and serviced apartment rooms across the city, only 22,000 can be classified as quality supply - which not only highlights the need for quality hospitality accommodation, but also serves as a reflection of the guest profile given that affordability is a primary concern for most pilgrims.

The pipeline of quality hotel offerings are dominated by 4-Star properties, which account for 55% of the forthcoming 21,806 quality keys estimated to enter the market by 2021. These figures do not include megaprojects that are still in the planning phase – the most notable of which include Thakher City, King Abdulaziz Road Development and Rou'al Haram.

Trading performance

Performance in Makkah's hotel market has been softening in recent years, with RevPAR levels falling to SAR 431 in 2017, representing a decline of 15% from the previous year. The decrease in performance was attributable to the state of the regional economy, specific currency issues (notably Egypt and Turkey), regional tensions, fee revisions and visa regulations.

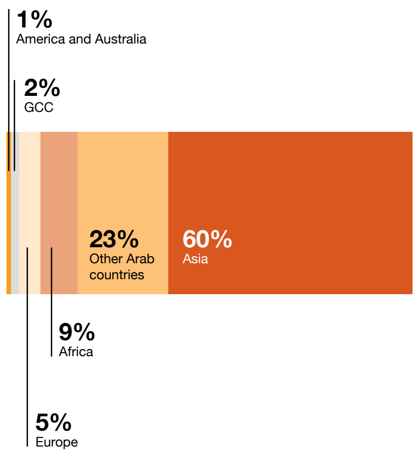
In the short-term, overall occupancy and average daily rates are anticipated to face continued pressure, and hotels in primary locations will prove to be the most resilient. Given historic precedence, performance declines disproportionally impact properties that are not on the front line in times of subdued demand, and as a result such properties are far more susceptible to market shifts. As such, it is not uncommon for properties in these locations to run at annual occupancy levels in the range of 30%-40% compared to 70%-80% on the front line.

While YTD August hotel performance in Makkah appeared to indicate that performance declines had bottomed out, this was not the case. The improvement was attributable to differences between the Gregorian and Hijri Calendars. Last year, Hajj fell between August 30th and September 4th, and as a result, the associated spike in performance primarily occurred in September. In 2018, the entire Hajj period took place in August, and therefore monthly performance improved significantly this year over the previous one. In September, the numbers normalized, and RevPAR levels settled 9.6% behind where they were the previous year. This RevPAR decline has been led by a rate rather than occupancy issue, which is reflective of the wider market conditions throughout the GCC.

Conclusion

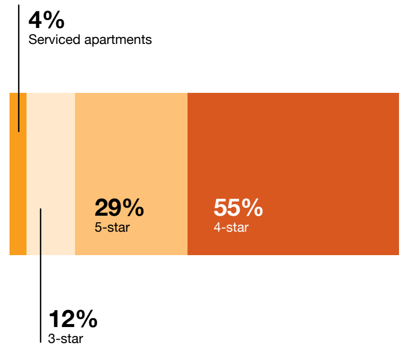
Like most major GCC cities, the hospitality sector in Makkah has faced headwinds in recent years due to a variety of factors. The opening of the Haramain High Speed rail and significant progress with the enhancement works at King Abdulaziz International airport are strong signals that the infrastructure is catching up to governmental ambitions for the city, but ultimately legislative and financial constraints still need to be fine-tuned in order to fully maximise the potential of inbound visitation. As mega-developments continue to be announced and executed, we expect the government to relax visa quotas and increase tourist flows sharply in the short to medium term. In turn, as the city becomes more developed, the expectation is that the values of prime real estate - particularly on the front line of the Haram - will increase at a disproportional rate in relation to stock further from the Haram.

FIGURE 2
Inbound Hajj visitation, 2018



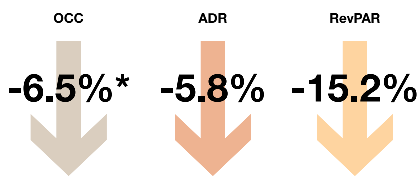
Source: Ministry of Hajj and Umrah, Knight Frank Research

FIGURE 3
Future quality supply by classification, 2018–2021



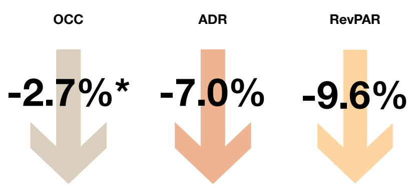
Source: STR, Knight Frank Research

FIGURE 4
Change in Makkah's KPIs, 2016–2017



*Note: *percentage points*
Source: STR, Knight Frank Research

FIGURE 5
Change in Makkah's KPIs,
YTD Sep 2017 - YTD Sep 2018



*Note: *percentage points*
Source: STR, Knight Frank Research

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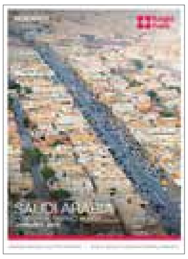

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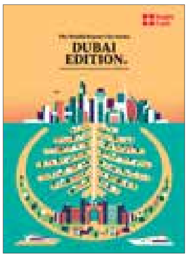

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