

HOTEL yearbook 2010

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The outlook for 20 key markets,
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How the crisis
will affect luxury in 2010

Editorial input from 25 hotel
industry CEOs

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Boutique DESIGN New York, a new hospitality interiors trade fair, will coincide with the 94-year-old International Hotel/Motel & Restaurant Show (IH/M&RS). Designers, architects, purchasers and developers will join the hotel owners/operators already attending IH/M&RS to view the best hospitality design offerings as well as explore a model room, exciting trend pavilion and an uplifting illy® networking café.



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Hotel development in Russia : a progression or regression in 2010 ?

A continuing imbalance between supply and demand will characterize the Russian hotel market in 2010, writes **MICHAEL O'HARE**, Managing Director of **HORWATH HTL HUNGARY & RUSSIA**. In principle, that should mean that projects will go forward at a good pace. Yet many of the country's structural obstacles stubbornly remain in place.

To get a better handle on whether Russia is going to progress or regress in terms of development output for 2010, let's examine the key questions being asked – and more importantly the views being expressed – by industry leaders and specialists in the Russian market.

As we draw closer to the end of what has been a very tough year in trading terms, how difficult will it be going forward to get the momentum going once again in terms of development deals being realized?

As far as Russia is concerned, the momentum has slowed but due to the continued imbalance of supply and demand, there remains a strong desire to expedite projects. 2009 has seen many projects been postponed, delayed and cancelled due to lack of available finance in the capital markets. Foreign banks, with very few exceptions, have withdrawn support for developers, and local Russian financial institutions are demanding high equity inputs, not to mention exorbitant interest rates.

Developers have had to increasingly look to hotel companies as introducers of debt finance and investors.

The fact is sometimes overlooked that a considerable number of projects carried on through construction phase over the last 12 months as project finance had been secured in pre-crisis times and had not been withdrawn, as the projects were expected to be completed and trading by the time the market analysts anticipated signs of normality once again by 2011/2012.

The desire by hotel companies to forge ahead with the development of new hotels in Russia of all sizes, categories and standards remains undiluted, again always recognizing Europe's only extreme imbalance of supply and demand, which exists not only in Moscow and St Petersburg but across this vast country in cities the size of Liverpool to Lyon that as yet do not boast one international hotel.

One thing is clear, the number of hotel management/franchise contract signings, and to a lesser extent lease agreements, continues regardless, across a wide range of brand types. Most hotel developers anticipate an increase in the number of deals signed in 2010.

What factors are likely to mitigate the acceleration of development?

Clever ways of formulating deals particularly from a financing perspective are clearly the order of the day, reducing return expectations in the short term until the opportunity to refinance presents itself. The fall in the cost of construction and land prices since 2008 is beginning to provide a platform for justifying projects and mitigating the perceived risk at present.

A predominance of domestic, as against international, investors is going to be necessary to move projects along at a faster pace than that experienced in 2009.

Where are the most significant opportunities in the market?

The continued rollout of predominantly mid-market branded hotels such as Holiday Inns, Park Inns, Courtyard by Marriott, Hilton Garden Inn, Novotel and Sokos hotels throughout the country's regional cities represents the most attractive opportunity for investors and international hoteliers alike. Although the demand for branded economy and budget type hotels exists, the difficulty in attaining and securing a sufficient number of land plots to justify the rapid development of a chain remains evasive. Boutique/lifestyle hotels are the vogue in Western Europe and there appears to be an increasing demand for such products in fashion-conscious Russia.

What will be the main barriers to development in 2010, aside from the obvious financing difficulties that developers are facing at present?

Many of the issues that international and domestic investors and developers keen to participate in hotel real estate investment opportunities continually come up against continue to be:

- *Ownership and title to land* – this still remains a long and arduous procedure and seems to be the prime blocking issue in Russia.
- *Sourcing the right local partner* – much time has been wasted where the local partner has proved to be unreliable and wields too little influence with local authorities.
- *Development timetable* – still generally slow by international comparisons but has improved as hotel developers have become more familiar with the mechanisms of the system, but nonetheless, taken on average it is still taking three years or more to develop a hotel from inception stage to opening.

What will be the key issues in terms of hotel development that will need to be addressed going forward?

- Identification of the *best market opportunities* in the regional cities that can significantly reduce development time.
- *Securing of sites* at significantly reduced values over next 12 months.
- Ability to negotiate *competitive* tender pricing whilst market remains flat.
- Examining the viability of *converting offices to hotels* as the demand for office space remains stagnant.
- Conversion of *existing as against new-build properties* which should continue to come on the market at more attractive prices – greenfield sites are clearly favored, although in some cities this is not so easy to secure prime locations without demolition/conversion of existing buildings.
- Awareness of the «*white elephant factor*» – standard of hotel product – inevitably there are those investors who aspire to upscale hotels where clearly the market opportunity is still not really that evident in Russia's key regional cities.
- Establishing the optimum hotel brand – with many hotel operators competing for the same project, it is not always easy to ascertain the most suitable brand rather, in some cases, it could evolve out of an owner's ability to attain the



most legally secure and financially lucrative management or franchise agreement.

- A longer-term view needs to be taken in terms of investment – recognition of the fact that projects in Russia will be competing with those in other parts of the world where projected returns may be less but finance is cheaper and political and economic risk is perceived to be less.

So what do we conclude for 2010?

There have been early indications that the activity in hotel development will begin to pick up in the first half of 2010 as more funds become available to the market. Russia should be set to recover quickly as it is bound by its own market dynamics dictated largely by energy prices.

The rate of development should begin pick up once again, and while the market may have slowed down in 2009, interest in investing in the hotel sector in Russia remains high.

Progression... ■



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