OVERVIEW

2011

HOTEL REAL ESTATE MARKET

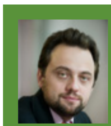
Moscow

Knight Frank

EXECUTIVE SUMMARY

- In 2011, six hotels with a total of 1,150 rooms were opened in Moscow.
- As of the beginning of 2012 total supply of rooms in the city's 3-5★ hotels was 31 thousand rooms of which approximately one third (10 thousand rooms) are in hotels managed by international operators.
- According to preliminary data Moscow saw about 4.15 mln foreign visitors in 2011, which is a 4% increase on the 2010 figure.
- Comparable growth in supply and inbound tourism to the city in 2011 resulted in average market occupancy remaining at 2010 level across the Moscow hotel segment.
- After a period of stable prices in 2010, throughout the past year average room rates (ARR) in Moscow were going up across all hotel categories.
- Based on the 2011 results, the Moscow hotel industry retained its number five position among European capital cities across all key commercial performance indicators.

HOTEL REAL ESTATE MARKET



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"2011 saw increased investment in the city's hospitality segment which resulted in an all-time high number of investment deals closed during the year and start of new and restart of stalled hotel development projects. We have to emphasize the role played by the Moscow Government in achieving this result.

As part of a non-core assets privatizationprogram, several city's landmark hotels were sold, including Moskva and National. In addition, a number of bills were initiated to promote the development of the city's hospitality sector."

Positive business environment in early 2011, in particular, high energy prices, provided an impetus for economic growth in Russia. A recovery in key macroeconomic indicators for Russia contributed to growth of the Moscow hotel property market. On the other hand, increased uncertainty in global financial markets and debt problems in the European Union caused some decline in business activity towards the end of the year, which may potentially lead to a future decline in business travel.

Basic performance indicators 3-5★hotels, Moscow		Change
Operating hotels, total	160	↑
Number of rooms in operating hotels, total	31,000	↑
Significant hotel projects completed in 2011 (number of hotels / number of rooms)	6 / 1,150	
Significant hotel projects scheduled for completion in 2012 (number of hotels / number of rooms)	7 / 1,675	
Average room rate (ARR), 5★ hotels	$310	↑
Average room rate (ARR), 4★ hotels	$197	↑
Average room rate (ARR), 3★ hotels	$118	↑
Average occupancy rate, 5★ hotels	57%	→
Average occupancy rate, 4★ hotels	65%	↓
Average occupancy rate, 3★ hotels	61%	↑

Source: Knight Frank Research, 2012

Main events

- In 2011, several investment deals were signed in hotel property segment:
  - In February the acquisition by Radisson Royal of Soyuz hotel was announced (3★, 115 rooms, Universitetsky Ave, 12) with a view to renovation.
  - In March, Gals-Development (the former name System-Gals) announced the closure of its acquisition of Peking Hotel (3★, 135 rooms, Bolshaya Sadovaya St., 5/1). The hotel building is to be converted into a 5★ property under the Fairmont Hotels & Resorts brand.
  - In April, Verny Kapital acquired from Capital Partners a Ritz-Carlton hotel (5★, 334 rooms, Tverskaya St., 3). Financial details of the deal have not been disclosed, but experts estimate the contract price to be around $650 million.
  - In early July, Mikael Shishkhanov, President of Binbank, purchased a 49% interest in Dekmos (the company carrying out Moskva hotel renovation project) previously owned by Gostinichnaya Kompaniya.
  - In late July, as part of a portfolio restructuring and non-core assets disposal program, Rosatom sold its Baikal hotel (the sum is 426.5 million rubles).
  - In October, an auction was held for National, one of Moscow's oldest hotels (5★, 201 rooms, Tverskaya St., 1). The new owner is the Gutserievs' family that bought it from the Moscow Government for RUR 4.6 billion.

The most significant hotels commissioned in 2011

Project	Address	Category	Number of rooms
Q1			
Crowne Plaza Club	Krasnopresnenskaya Emb., 12	5★	149
Ramada Moscow Domodedovo*	5 km from Domodedovo airport	4★	134
Q2			
Radisson Blu Belorusskaya Hotel	3rd Yamskogo Polya St., 26	4★	264
Amin'evskaya	Amin'evskoe Hwy, 5	3★	223
Q3			
No large scale projects were completed			
Q4			
Intercontinental Moscow Tverskaya	Tverskaya St., 22	5★	203
Courtyard Paveletskaya	Kozhevnicheskaya St., 8/4	4★	170

* Ramada Moscow Domodedovo, though located in Moscow Region, falls into the Moscow city's hotel market, as it mostly caters to guests arriving in Moscow

Source: Knight Frank Research, 2012

- In May, the Tourism Committee of Moscow changed name to the Committee for Tourism and Hospitality Business. From now on, in addition to tourism development policy implementation and regulatory functions, the committee's terms of reference will include coordinating the city's hotel segment.
- In September it became known that the city's Architecture Committee was going to come up with a revised location plan for hotels in Moscow. Under the plan, a fixed number of hotel projects is to be built in each administrative district.
- In October, the Recreation and Tourism Industry Development Program for 2012-2016 was adopted with a view to realize the city's tourism potential. Budget allocated by the municipal Government to the program is 125 billion rubles.

Supply

In 2011, six new hotels with a total of 1,150 rooms were opened in Moscow, which is in line with the market average year-on year-supply growth rate in Moscow (around 4%).

Intercontinental Hotels Group opened two hotels under its brands in 2011: in March, the deluxe wing of Crowne Plaza hotel was opened (5★, 149 rooms), and deluxe hotel Intercontinental Moscow Tverskaya (5★, 203 rooms) forming part of mixed-use development Summit welcomed its first guests in December. Rezidor Group opened its fifth hotel project in Moscow Radisson Blu Belorusskaya (4★, 264 rooms), and Courtyard Moscow Paveletskaya (4★, 170 rooms) became the seventh Marriott International hotel to be opened in the city. Also in 2011, Wyndham Hotels opened Ramada Moscow Domodedovo, the first hotel in Moscow Region under the Ramada brand (4★, 134 rooms)*, located near Domodedovo airport. So, five of the six hotels opened in 2011 entered the market under international brands, and the sixth one – Amin'evskaya – became the first Moscomstroy project to be built under the affordable hotel development program being implemented in Moscow based on redeveloped hostel buildings.

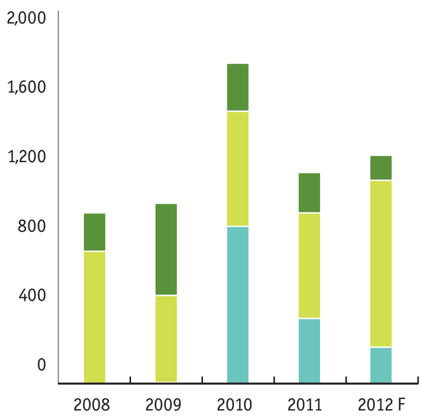
In July 2011, Vega hotel (3★, 967 rooms) joined the Best Western hotel group, thus becoming the largest hotel in Moscow in terms of the number of rooms under international management. We note that the transition of operating hotels to international management without significant prior renovation is a positive, though rare practice in the Moscow hotel market. A successful example is Sheremetevo 2 (3★, 251 rooms) that since 2010 has been operating under the Park Inn brand (Rezidor).

Half of new rooms completed in 2011 are in 4★ hotels; 3★ and 5★ rooms account for 31% and 19%, respectively. Interestingly, in the year before last, the distribution of new 4-5★ rooms was inverse: 5★ rooms made up more than 50% of new supply, while 4★ rooms accounted for about 35%. In contrast, year-on-year increase in room inventory in economy hotel segment remains stable at 10-15%. The fact that developers tend opt for higher end projects is largely due to higher yield they deliver compared to middle market properties (in 2011, RevPAR in upscale hotels (4-5★) was $142 – twice that of 3* hotels ($72)).

As of the beginning of 2012, total room stock in the city (3-5★ hotels) was 31 thousand rooms, of which about a third (10 thousand) were international brands. We note that global hotel operators become increasingly interested in Russian market as a whole and Moscow in particular. E.g. Hilton Worldwide announced plans to extend its network in Russia to 23 hotels including operating projects and those under construction. Intercontinental Hotels Group expects by 2020 to operate a total of 100 hotels in Russia and CIS

The share of 4★ hotels in new supply is gradually increasing

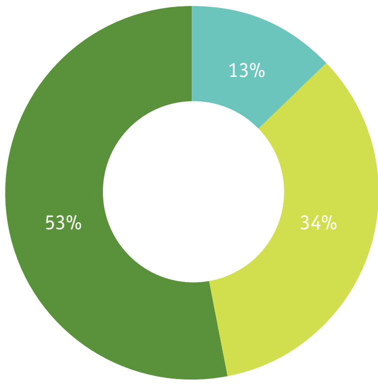
number of rooms



Source: Knight Frank Research, 2012

The supply is dominated by 3★ hotels that account for more than 50% of total room stock in the city

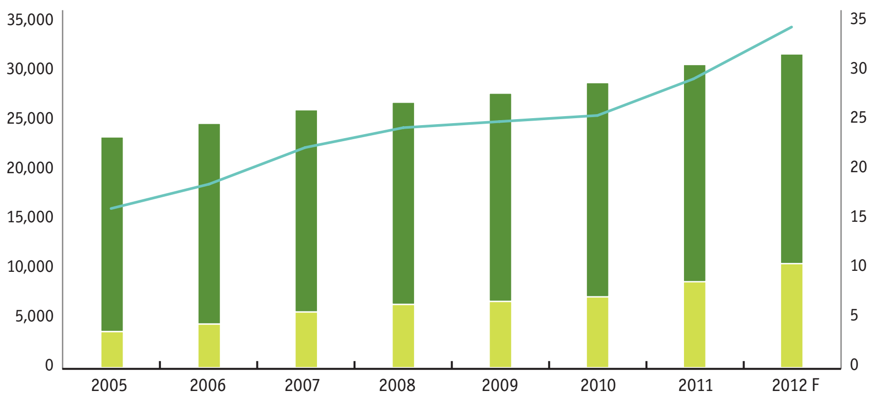
%



Source: Knight Frank Research, 2012

In the last three years the share of rooms in internationally managed hotels has increased 7%

number of rooms %



Source: Knight Frank Research, 2012

(currently there are 16 operating hotels under IHG brands, including 11 in the RF). The predominance of international hotel chains in new supply – about 80% – is largely responsible for the growth in quality room stock meeting high international standards. High interest from international operators to the Russian hospitality market testifies to the country's potential.

As far as the geographical spread of hotel properties is concerned, we note that, given the strong demand from business travel segment, a logical approach to future development is to build new hotels in districts with high concentration of office uses, as they do in Paris, London, and other major commercial cities. The trend is supported by the locations of hotels opened in 2011.

For instance, the deluxe wing of Crowne Plaza hotel was opened in the immediate neighborhood of Moskva City as part of the World Trade Center. Radisson Blu Belorusskaya Hotel and Intercontinental Moscow are located in a vibrant new business district Belorussky, and Courtyard by Marriot Paveletskaya – in an established business area surrounding Paveletskaya railway station.

Demand

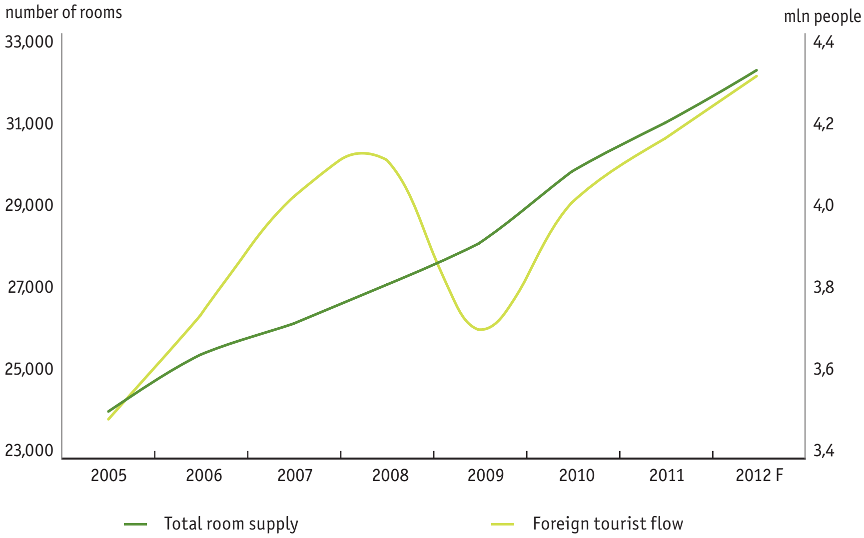
In 2011, the tourism industry continued to recover, but at a slower pace than in 2010 and the pre-recession years, which is due to increased instability of the global economy. According to the World Tourism Organization (UNWTO), the increase in the total number of international tourists in 2011 was 4.4% (2010: 6.9%, 2005-2007: 5.6% on average).

In terms of inward tourism, Russia ranks 20th in the UNWTO rating. Our analysis of the first nine months of 2011 suggests that at the end of the year the number of foreign visitors to Russia will likely be more than 23 million.

As the administrative, commercial, financial and cultural center of the Russian Federation, Moscow receives around one fifth of all foreign visitors to Russia each year. According to a preliminary estimate, in 2011 Moscow saw around 4.15 million foreign visitors: a 4% increase in the Moscow's inbound international tourist traffic compared with the previous year.

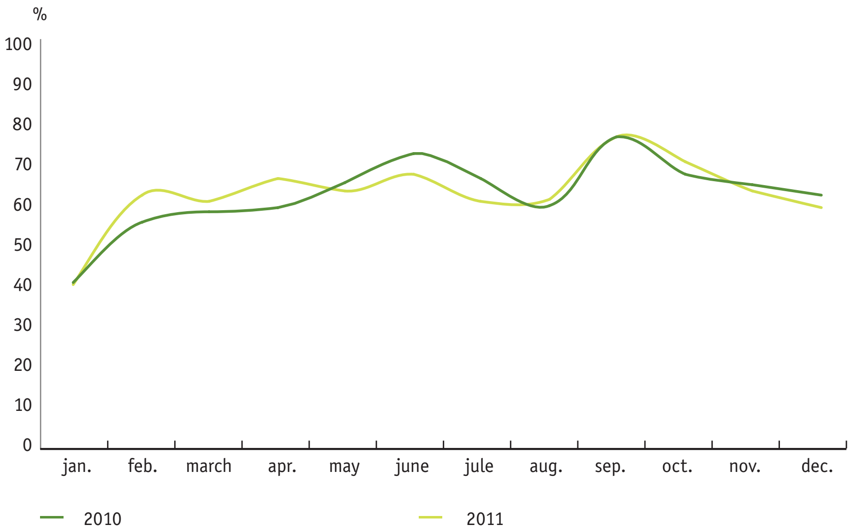
Foreign nationals account on average for 25 to 50% of demand for hotel accommodation in Moscow depending on hotel category; as a rule, they choose to stay at renowned international hotel chains.

Inbound international tourism flow to Moscow is generally on a par with the amount of new supply, with deviations from the trend line caused by market fluctuations



Source: Knight Frank Research, 2012

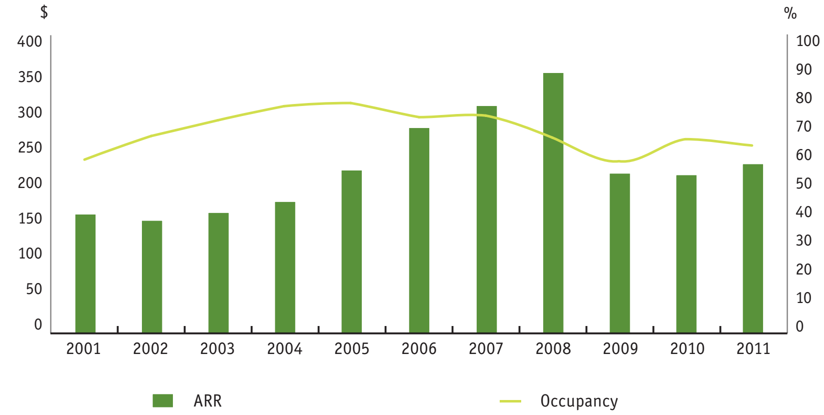
In 2011, occupancy rates in 3-5★ hotels in Moscow were generally on a par with the previous year's figures.



Source: Knight Frank Research, 2012

It is clear from a comparison between inbound international tourism traffic figures and occupancy rates in Moscow, that the two are closely related, and that the increased supply has a deterrent effect on occupancy rates. Thus, in 2007, in Moscow there were 6.7 hotel rooms per 1000 foreign tourists, and in 2011, the ratio increased to 7.5 rooms / 1,000 guests. As a result, average annual occupancy stabilized at 62%. In 2011, occupancy rates in the 4-5★ hotel segment fell 2.2 percentage points (p.p.) from 2010 to 62.5% against the backdrop of a significant increase in new supply (more than 2,300 rooms over the last two years). In mid price segment, occupancy rates continued to recover: as of the end of the last year the occupancy of 3★ hotels increased 2.5 p.p. to 61%.

In 2011, prices for upscale (4-5★) accommodation picked up in Moscow, but at a much slower rate than in the pre-recession period



Source: Knight Frank Research, 2012

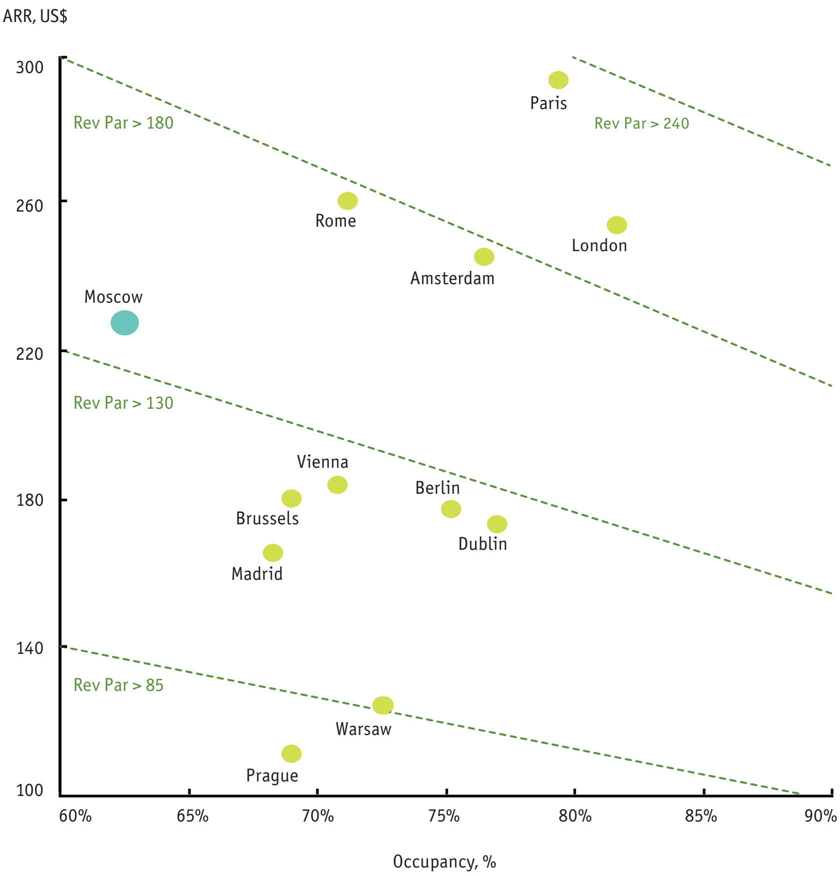
Business travelers make up the bulk of demand for hotel accommodation in Moscow. The continued dependence of occupancy rates on business environment is evident from our analysis of movements in this ratio in different time intervals (week, month, year). The development of congress and exhibition tourism, a segment that so far remains underdeveloped in Moscow, could help improve occupancy during summer months and smooth occupancy fluctuations during the week.

Commercial terms

In 2011, the Moscow hotel market saw a positive growth across operating performance indices. After a stabilized period the year before, in 2011 an increase in average room rate (ARR) was observed in all hotel categories. Average year-on-year increase in ARR compared to the same period of 2010 in US dollar terms ranged from 5% to 11% depending on the segment. The cost of 5★ hotel accommodation was around $310, and $197 and $118 for 4★ and 3★ accommodation, respectively .

An increase in room rates resulted in improved revenue per available room (RevPar) figures across the city's hotel market. The upward trend was particularly noticeable in the economy segment which was a result of improved occupancy: as a consequence, their RevPar increased 13% to $72. In the 4-5★ segment the growth was less marked because of a decline in occupancy and totaled around 2%.

In 2011, the Moscow hotel industry has retained fifth place in Europe in terms of commercial performance



Source: Knight Frank Research, 2012

In terms of average room rate (ARR), Moscow has traditionally ranked among top European cities, and for a long period of time led the market in both absolute terms and relative growth rate: in the period from 2005 through 2008, year-on-year increase in ARR was 18%. Revenue per available room (RevPar) was even more impressive amid relatively high occupancy rates, with average year-on-year increase of 25%. Following the drop in room rates by more than 40% in 2009 caused by the global recession, Moscow lost its number one position in the European hotel rating in terms of commercial performance and has consistently held the fifth place for two years in a row.

Outlook

Several large hotel development projects with a total of over 1,600 rooms have been announced for completion in 2012. These include two hotels under brands that are not yet present in Moscow.

- The opening of DoubleTree by Hilton Moscow may become a significant market event: on Leningradskoe Hwy (4★, 270 rooms) and in Vnukovo airport (4★, 443 rooms);
- In February 2012, Mercure Arbat is scheduled to open for business (4★, 103 rooms).

As of the beginning of 2012, more than 25 hotel projects totaling 7,000 rooms are at various stages of design and development in the Russian capital. Our analysis of the hotel development projects suggests that the proportion of economy hotels, including those under international management, is gradually going up. In particular, in 2013 the world's largest Holiday Inn hotel (3★, 1000 rooms) is scheduled to be opened in Moscow, and the first of the four Ibis projects scheduled for opening in the next four years has been launched.

Significant hotel projects scheduled for commissioning in 2012

Project	Address	Category	Number of rooms
Kempinski Hotel Nikolskaya	Nikolskaya St., 12/1	5★	200
DoubleTree by Hilton	Vnukovo airport	4★	443
Novotel Moscow-City	Moscow-City, 8A	4★	362
DoubleTree Leningradsky Riverside	Leningradskoye Hwy, 39	4★	270
Hilton Garden Inn New Riga	Novorizhskoye Hwy	4★	162
Mercure Arbat	Smolenskaya Sq., 6	4★	103
Azimuth Hotel Moscow	Novodanilovskaya Emb., 9	3★	134

Source: Knight Frank Research, 2012

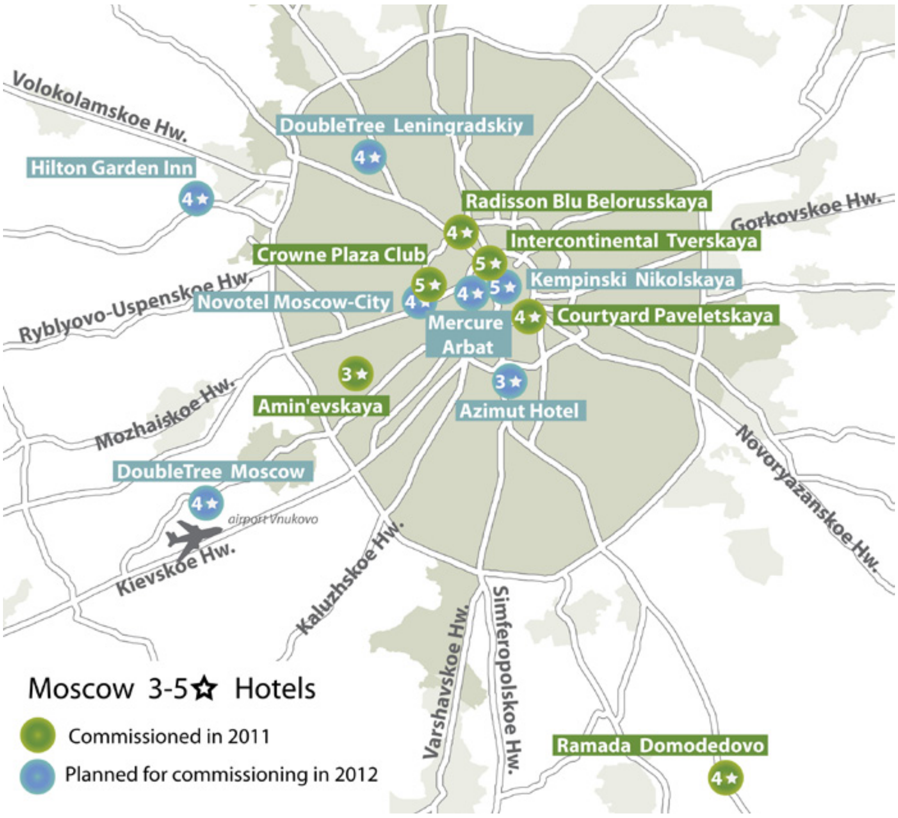
2011
HOTEL REAL ESTATE MARKET

Moscow

Since recently, the Moscow authorities have increasingly focused on hospitality industry. In particular, they developed the Recreation and Tourism Industry Development Program for 2012-2016 which provided for an increase in the city's room stock by 4,500 rooms by 2016. However, for it to succeed, ongoing monitoring by the government and further measures to encourage hotel development will be required.

The program also aims to increase inbound tourism traffic to 4.5 million in 2012, which is a 5% increase on 2011, and to 6.6 mln in 2015. If tourist traffic grows as expected, new supply will likely help keep occupancy rates in the upscale segment at their current level.

As far as operating performance is concerned, the slowdown in growth rates across key performance indicators observed in late 2011 as a result of increased uncertainty in the global economy, is likely to continue into 2012.



Brief glossary of basic terms

Rack Rate - the full advertised price of a hotel room net of any discounts.

ARR (Average Room Rate) - mean price charge for a given period of time (night, month, year). It can be calculated by dividing the total rooms revenue by the number of rooms sold in that period of time.

Occupancy, Occ. Rate - the proportion of rooms sold to total rooms available for sale for a given period of time (night, month, year), expressed as a percentage.

RevPAR (Revenue Per Available Room) - Average revenue per one room in a given period of time (night, month, year). It can be calculated by dividing the total rooms revenue by the number of rooms available for sale in that period of time. This ratio is mathematically equal to the product of average room rate by occupancy rate.

OVERVIEW

Europe
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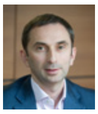

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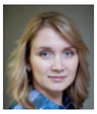

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