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# Hotel Values in Russia, the CIS and Georgia – 2009

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*The objective of this publication is to provide an indication of hotel values and trends in the main markets of Russia, the CIS and Georgia and to show how values in the region have been affected by the global economic crisis, and the subsequent reduction in trading and investor appetite. This publication also outlines the HVS valuation methodology for hotels that has become the industry standard throughout the world.*

**Article Outline**



## *Introduction*

Hotel markets in a number of key cities in Russia, the CIS and Georgia are nearing a level of maturity. Until recently, HVS was predominantly involved in feasibility studies in these emerging markets, seeking to address the shortage of quality hotel rooms in the region. Now, in addition to feasibility studies, we are seeing increasing appetite for valuation reports as hotel markets become more established.

Although most of the valuation assignments are still for financing purposes, we consider it only a matter of time before our more sophisticated methodology to value hotels is also adopted for transaction purposes in the region. The lack of a formal methodology is widely understood to be one of the main reasons why there are still relatively few hotel transactions in these markets and why most of these transactions lack transparency.

The increase in valuation activity has led us to expand our annual European Hotel Valuation Index (HVI) to include this region. Established in 1993, the European HVI is a sophisticated valuation benchmark estimating and tracking trends in hotel Market Values for 36 key European markets (including Moscow and St Petersburg).

This is our first valuation publication for this region, although we have tracked performance and value trends for 12 key cities since 2007. This publication also helps explain how the Market Value of a hotel in a particular city included in this survey compares to that of other key cities in the region, as well as those in the 34 key cities in Europe identified in the European HVI 2010 (Table 9).

With 30 years of valuation experience HVS has set the industry standard on how to value hotels. This publication will also briefly revisit the methodology used for valuing hotels.

## *Hotel Values in the Region*

The methodology employed in estimating the hotel values in this publication is based on operating data from a representative sample of hotels in the respective markets. These data are then aggregated to produce a pro forma performance for a typical hotel in each market. Based on our experience of real-life hotel financing structures gained from valuing hotels in the region, we have determined valuation parameters for each market that reflect both short-term and longer term sustainable financing structures. These market-specific valuation and capitalisation parameters are applied to the net operating income for a typical hotel in each city. Investor appetite for each market at the end of each year is reflected in the capitalisation rates used. The HVI assumes a valuation date of 31 December. Values are based on market performance but the capitalisation rates reflect the anticipated future performance trends, the competitive environment, the cost of debt and the cost of equity as at the date of value. As our opinion of value remains an opinion of Market Value, when analysing transactions and in assessing the opinions of value we have attempted to remove all aspects of distress and transactions that were not conducted at arm's length or did not have a sufficient marketing period. The parameters adopted have reflected the "new world order" of financing but assume a reasonable level of debt and investor sentiment. Conversely, the values reported may not bear comparison with (the few) actual transactions completed in the region.

It should be specifically noted that a value for a particular city is an average value across the better quality hotel supply in that city. If a city has largely five-star hotels with few, if any, four-star hotels, our estimate of value for that city will be higher than a city with no five-star hotels.

Hotel values change over time owing to different earning expectations and capitalisation rates. This publication is designed to illustrate these changes and to quantify the amount of variance attributable to movements in earnings and costs of debt and equity capital. In summary, the main factors contributing to the valuation are the following.

**Table 1 Main Considerations for Hotel Valuation**

| |
|---|
| RevPAR Performance |
| Revenue Mix (Rooms, food and beverage, other) |
| Cost Structure/Net Operating Income |
| Hotel Market Structure (branded and/or quality supply) |
| Planned New Supply (confirmed) |
| Market Outlook |
| Investor Sentiment |

For this first edition of this publication, we have chosen to include the following major hotel markets in the region.

**Table 2 List of Cities Considered**

| | |
|---|---|
| **Armenia** | Yerevan |
| **Azerbaijan** | Baku |
| **Georgia** | Tbilisi |
| **Kazakhstan** | Almaty |
| | Astana |
| **Russia** | Kazan |
| | Moscow |
| | Rostov-on-Don |
| | Samara |
| | St Petersburg |
| | Yekaterinburg |
| **Ukraine** | Kiev |

We have selected these markets as they have a sizeable sample of better quality hotels. Applying the aforementioned methodology, Table 3 presents the value indication for key cities in Russia, the CIS and Georgia from 2007-09, in descending order. We have shown these values in euro currency to assist comparability.

**Table 3 HVS Estimates of Hotel Values (€)**

| | 2007 | 2008 | 2009 |
|---|---|---|---|
| Moscow | 518,000 | 466,000 | 310,000 |
| St Petersburg | 422,000 | 397,000 | 216,000 |
| **European Average** | **274,000** | **245,000** | **212,000** |
| Baku | 292,000 | 245,000 | 205,000 |
| Kiev | 427,000 | 376,000 | 194,000 |
| Almaty | 418,000 | 293,000 | 190,000 |
| Astana | 329,000 | 224,000 | 179,000 |
| **Average – Russia, the CIS and Georgia** | **280,000** | **239,000** | **161,000** |
| Tbilisi | 273,000 | 213,000 | 156,000 |
| Yekaterinburg | 143,000 | 148,000 | 106,000 |
| Kazan | 119,000 | 130,000 | 102,000 |
| Rostov-on-Don | 126,000 | 133,000 | 96,000 |
| Samara | 156,000 | 145,000 | 88,000 |
| Yerevan | 134,000 | 100,000 | 85,000 |

Source: HVS London Office

It is not surprising that Moscow leads the value table with the highest value per room of in excess of €300,000. High RevPAR and greater concentration of luxury and upscale properties have helped Moscow reach the top position in euro terms. Moscow had the eighth highest value per room in the 2009 European HVI, down four places from 2008 largely on account of the rouble's devaluation.

Russia's northern 'capital' St Petersburg ranks second, albeit at a noticeable value differential to Moscow. A strong value per room of some €200,000 is also largely attributed to the sizeable stock of luxury rooms available in the city. St Petersburg also had the 12th highest value per room in the 2009 European HVI, down six places from 2008.

It is worthwhile noting that Moscow and St Petersburg are the only two cities included in this survey that rank above the European HVI average. A value comparison between the region and the European markets is detailed in Table 9.

The capitals of the CIS countries included in this survey follow Moscow and St Petersburg in terms of average hotel values. Baku and Kiev are both strong commercial markets with limited supply (mostly in the upscale segment) and thus have strong average rates. With Kazakhstan's wealth of natural resources, Almaty and Astana show a similar pattern, albeit with less new supply in the pipeline. The Kazakh cities also rank in the first half of the value table.

Relatively modest average rates and a lack of upscale hotel supply in Russia's regions place these cities below the value average in this publication (€161,000). Poor (albeit stable) RevPAR performance and a lack of commercial demand generators and branded hotels puts Yerevan at the bottom of this table.

Table 4 shows the cities' ranking according to value per room between 2007 and 2009.

**Table 4 Value Ranking**

| | 2007 | 2008 | 2009 |
|---|---|---|---|
| Moscow | 1 | 1 | 1 |
| St Petersburg | 3 | 2 | 2 |
| **European Average** | **8** | **5** | **3** |
| Baku | 6 | 6 | 4 |
| Kiev | 2 | 3 | 5 |
| Almaty | 4 | 4 | 6 |
| Astana | 5 | 8 | 7 |
| **Average – Russia, the CIS and Georgia** | **7** | **7** | **8** |
| Tbilisi | 9 | 9 | 9 |
| Yekaterinburg | 11 | 10 | 10 |
| Kazan | 14 | 13 | 11 |
| Rostov-on-Don | 13 | 12 | 12 |
| Samara | 10 | 11 | 13 |
| Yerevan | 12 | 14 | 14 |

Source: HVS London Office

While Moscow has consistently held the top position over the three years under review, it is notable that Kiev came second in 2007, just above St Petersburg. Kiev was, at the time, experiencing a real-estate boom and a lot of investor interest, coupled with strong average rates.

The ranking average of European hotels, as indicated in the European HVI has significantly improved when compared to hotels in Russia, the CIS and Georgia (moving from 8th place in 2007 to 3rd in 2009). In other words, hotel values in Russia and the CIS have weakened in euro terms comparatively more than their European counterparts. In 2007, many cities in Russia and the CIS were able to command a premium on their average rates because of acute undersupply, while operating costs were low compared with Europe. Despite a higher risk profile and relatively expensive debt, this resulted in the region's strong value per room performance. However, with the recent economic conditions, investor appetite for emerging markets decreased and financing became even more difficult and expensive.

Table 5 illustrates the percentage change in values from 2007 in euro.

**Table 5 Value Change in Euro 2008-09 (%)**

| Growth/Decline | 2008 | 2009 |
|---|---|---|
| Kiev | -12% | -48% |
| St Petersburg | -6% | -46% |
| Samara | -7% | -39% |
| Almaty | -30% | -35% |
| Moscow | -10% | -33% |
| **Average – Russia, the CIS and Georgia** | **-15%** | **-33%** |
| Yekaterinburg | +3% | -28% |
| Rostov-on-Don | +6% | -28% |
| Tbilisi | -22% | -27% |
| Kazan | +9% | -22% |
| Astana | -32% | -20% |
| Baku | -16% | -16% |
| Yerevan | -25% | -15% |
| **European Average** | **-11%** | **-13%** |

Source: HVS London Office

Kiev recorded the highest drop in value in euro terms in 2009 of some 48%, owing to the Ukraine's sharp GDP decline as well as the devaluation of the local currency. Hotels in St Petersburg saw average values drop by nearly as much (46%) owing to the drying up of commercial demand, exposing St Petersburg to highly seasonal leisure segment. Other cities in Russia were affected to a similar extent, mostly because of the devaluation of the rouble. Steady RevPAR performance in Yerevan and average rate growth in Baku cushioned the fall in values in these two cities.

All cities included in this publication showed a larger decline in value in 2009 than the European average, which is no surprise. All the countries listed above have suffered extreme currency fluctuations against the euro and as such it is also prudent to compare the change in values in each market's respective local currency.

Table 6 presents the change in values for the region in respective local currencies.

**Table 6 Value Change in Local Currency 2008-09 (%)**

| Growth/Decline | 2008 | 2009 |
|---|---|---|
| St Petersburg | -5% | -34% |
| Tbilisi | -23% | -29% |
| Samara | -6% | -27% |
| Almaty | -26% | -25% |
| Kiev | -2% | -24% |
| Baku | -21% | -21% |
| **Average – Russia, the CIS and Georgia** | **-21%** | **-20%** |
| Moscow | -9% | -20% |
| Yekaterinburg | +5% | -13% |
| **European Average** | **-11%** | **-13%** |
| Rostov-on-Don | +7% | -13% |
| Astana | -28% | -7% |
| Yerevan | -28% | -5% |
| Kazan | +10% | -5% |

Source: HVS London Office

St Petersburg has shown the biggest decline owing to a significant drop in RevPAR and its dependence on the leisure segment. Samara had the third-highest decline because of its struggling car and manufacturing industries and, as a result, falling RevPAR.

Kazan and Yerevan had the lowest decline in values in 2009. Kazan is still considered a hotspot for hotel development with its stable and positive outlook. Yerevan showed modest RevPAR decline in 2009 and has little risk of new supply.

In summary, the decline in values in 2009 across all the cities surveyed arose due to difficult trading conditions and a subsequent fall in RevPAR. In addition, higher risk profiles and the cost of obtaining debt in this region have contributed to this significant decline.

Table 9, towards the end of this publication, illustrates how the values for key cities in the region compare to those of other key European cities, as indicated in our European HVI 2010.

## *Market Overviews*

The following paragraphs provide a short overview of each of the markets mentioned above (in descending order of value) to put the 2009 relative values and their decline into perspective.

### Moscow, Russia

The rouble's depreciation in 2009 failed to stimulate international visits to the Russian capital. Monthly occupancy levels recorded throughout 2009 fluctuated from six to almost 20 percentage points below 2008 levels, ending at 58% by the year's end, some 12% below the 2008 performance. Moscow's hotels also recorded a severe average rate decline in 2009 of 46% to €146, resulting in a RevPAR decrease of 55% (34% in local currency) to €85. These two years of slowdown in Moscow's headlong race to develop its hotel market prompted values per room to fall another 30% (albeit only around 20% in local currency) to €310,000. The city tops the league of hotel values in the region and was in 8th position in the European HVI. Supply in the city is expected to increase by more than 7,000 branded hotel rooms over the next three to four years, most of which will be in the upscale segment.

Given that Moscow is still currently undersupplied in terms of quality hotel rooms, and after considering the positive outlook for Moscow in the medium term, we estimate the value per room to be in the region of €310,000.

### St Petersburg, Russia

Similarly to Moscow, St Petersburg had registered record RevPAR growth for four years until 2008. In 2009, demand in the city decreased sharply, putting pressure on rates. St Petersburg has a relatively small commercial base and relies strongly on leisure demand on account of its rich cultural heritage. Emerging MICE (Meetings, Incentive, Conferences, and Exhibitions) demand helps the shoulder periods, but the city remains a highly seasonal market. Year-to-date performance in 2010 has seen occupancy recovering, although average rate is still contracting slightly.

In mid-2010, the Courtyard St Petersburg Centre West/Pushkin Hotel opened under a long-term management agreement with OOO Stroiprogress. In April 2010, Rezidor Group added a third Park Inn hotel near the Moskovsky train station. The city will see further room growth in the luxury segment with the opening of the W hotel in March 2011 and a new Four Seasons hotel, as well as several developments by InterContinental (Staybridge, Crowne Plaza). Simplified visa regulations and better air access would help the market expand its current demand base and absorb the new supply coming into the market.

As a seasonal market with a large share of leisure guests, St Petersburg saw a 20% decline in occupancy to 40% in2009. While the Russian economy is expected to recover in relation to oil prices, it is likely that Moscow will benefit first from this recovery, fuelling in turn renewed commercial demand to St Petersburg. The city remained in 2nd position in the value ranking with a value of €216,000 per room, which represents a 46% change in euro and a 34% change in local currency compared to 2008.

### Baku, Azerbaijan

With a population of 2 million, the base of Baku's economy is petroleum. The oil economy of Baku is undergoing continuous development with the exploitation of the massive Azeri-Chirag-Gunashli field by a BP-led consortium.

The 600-room quality hotel market in Baku currently consists of two Hyatt properties and two Rezidor hotels, of which the Park Inn is the only internationally branded mid-market hotel. Thanks to continuously high average rates fuelled by oil money, the city is expected to see a surge in supply with Four Seasons, JW Marriott, Hilton and Fairmont opening in the city in 2011 and 2012 (approximately 1,400 rooms).

Economic data indicate that Azerbaijan's growth is intrinsically linked to the oil and gas sector and thus fluctuates with movements in oil price, the performance of foreign energy companies and government demand. We note that the biggest challenge to Azerbaijan is the efficient diversification of its economy (so that the country can move away from its dependence on the oil and gas industries) and improved air access to Western Europe.

With oil demand affected by the economic crisis that hit the West in 2008, Baku experienced a RevPAR decline of 11% in 2008 and some 9% in 2009. With risk of oversupply and a correction of rates in relation to a strong historical performance, Baku registered two drops in value of 16% in both 2008 and 2009. We estimate the average value at €205,000 per room in Baku for 2009.

### Kiev, Ukraine

Historically, the Kiev hotel market was vastly undersupplied with most upscale hotels achieving average rates of several hundred euro. However, with more hotels opening and the advent of the economic crisis impacting demand, rates began to correct. The quality hotels in the market currently include the Hyatt, InterContinental, Radisson, Opera (Leading Hotels of the World), Riviera Hotel and Premier Palace hotel (totalling some 1,300 rooms). There is a large hotel pipeline for the city, which would at least double the current supply. Hilton and Fairmont are the most advanced projects, but Accor (Ibis) and Rezidor are planning further properties, opening (ideally) in time for the 2012 European Cup, although this deadline seems to be dwindling for most operators.

Owing to its dependence on commodity exports such as steel and on external financing, the Ukrainian economy has been one of the worst hit by the global financial and economic crisis. On the positive side, Kiev has a strong economy based in a populous country. Hotel demand is expected to remain driven by commercial segments, but MICE demand could help the city regain some growth in the medium term. The Ukrainian government recognises the importance of tourism revenues to the economy and is beginning to organise strategies to develop this sector.

Kiev hotels registered a RevPAR drop of 12% in 2008 and 48% in 2009, which was due to a very strong GDP reduction paired with a significant weakening of the Hryvnia against the euro from 0.13 to 0.09. As such, the average value indication for Kiev fell to €194,000 per room for 2009.

## Almaty, Kazakhstan

Kazakhstan's was one of the first Eastern Europe economies to go into recession in late 2007. Although Kazakhstan experienced only modest GDP growth of 1.2% in 2009, GDP is forecast to rise to some 5-6% from 2010 onwards based on higher oil prices, improving global conditions and efforts to support the non-oil sectors. However, financing is still extremely difficult to obtain and very expensive.

Despite losing its status as the capital to Astana in 1997, Almaty remains the major commercial centre of Kazakhstan. For a number of years, branded supply in the city consisted only of the Hyatt Regency and InterContinental properties. 2009 saw the opening of a 280-room Holiday Inn and a 262-room Rixos hotel, and a Royal Tulip property opened in summer 2010. In terms of new supply, Capital Partners is currently constructing the mixed-use 'Esentai' complex which includes a JW Marriott hotel, due to be completed by early 2013. The Medeu area of Almaty will see the opening of a Radisson hotel in early 2012 and the Kempinski Hotel Bayterek with 218 rooms and 195 apartments in 2011.

In 2011, the 7th Asian Winter Games will be hosted jointly by Almaty and Astana, which should spur further leisure visits to the city.

Scarcity of supply has led to high accommodation charges for the business community visiting Almaty. In 2009, supply in the city increased and, with commercial demand being more cautious, marketwide occupancy suffered. As such, we provide an indicative value per room for Almaty hotels of €190,000, a 35% drop compared to the 2008.

## Astana, Kazakhstan

Astana became the new capital of Kazakhstan in 1997**.** As a consequence, Astana has experienced enormous building projects as oil money is spent on government buildings, commercial buildings, parks, leisure centres, monuments and other ambitious projects. These various real estate developments were designed to help the capital grow into a commercial and leisure destination. Many projects, however, have recently been put on hold because of the current economic climate.

Astana's branded hotel supply is rather limited and includes a 198-room InterContinental hotel (which was rebranded to a Ramada Plaza in early 2010), a 182-room Radisson, and a 168-room Rixos hotel. In terms of new supply, Accor recently signed a deal for a 250-room Ibis hotel. Other hotel projects in Astana include a Hilton with extensive conference space, and a Ritz-Carlton which is intended to be located in the tallest skyscraper in the CIS. We understand that both these projects are currently on hold.

Owing to limited branded supply (mostly upscale) which has led to high average rates, together with the uncertainty surrounding new hotel projects and the overall risk associated with Kazakhstan hotels, values in the city dropped by 32% in 2008 and 20% in 2009. We estimate the value per room in the city to be approximately €179,000.

## Tbilisi, Georgia

Tbilisi is the industrial, social and cultural centre of Georgia. The city is also emerging as an important transit route for global energy and trade projects.

Since 2003, following the Rose Revolution, and until 2008, Tbilisi experienced considerably more stability with decreasing crime rates and an improved economy. Construction and real estate are the most rapidly growing fields of Tbilisi's economy. The financial services industry in the city is quite well developed and is a main driver for hotel demand. Together with the Georgian banks, British, French, German, Turkish, Arabian, Ukrainian, Russian and Kazakh banks are represented in Tbilisi.

A sharp slow-down in GDP in 2009 (-4.0% compared to 2.3% growth in 2008) is mainly due to lower investment, both foreign and domestic, and very limited bank lending. The construction, services and manufacturing sectors all experienced significant falls in activity during 2009. As such, the hotel market saw a significant decline in RevPAR in 2009.

Quality hotels in Tbilisi include a 140-room Sheraton, a 127-room Marriott, a 118-room Courtyard by Marriott, and a newly opened 249-room Radisson. Planned supply for Tbilisi includes proposed Kempinski, Park Hyatt and InterContinental hotels. A 66-key Citadines apartment hotel has also recently opened.

Values in Tbilisi hotels contracted by 22% in 2008 and by a further 27% in 2009 in euro terms (and similar levels in local currency). Although RevPAR was stable in 2008, the risk surrounding Georgia's conflict with Russia led to a decrease in investor appetite for Georgia. On the contrary, the drop in value in 2009 to €156,000 per room was largely due to a fall in RevPAR owing to a contraction of the economy.

## Yekaterinburg, Russia

Yekaterinburg is strategically located in the Urals federal districts between Europe and Asia, making it an important gateway city for both trade and tourism. Yekaterinburg is the fifth-largest city in Russia, with a population of 1.3 million.

Yekaterinburg is predominantly a business destination; however, the local authorities are making a concerted effort to attract more leisure demand to reposition the city as a leisure destination.

Yekaterinburg's branded hotel supply includes a 160-room Park Inn and three hotels that opened in 2009: a 297-room Hyatt, a 160-room Ramada and a 211-room Angelo hotel (managed by Vienna International). A 168-room Novotel opened in early 2010. Hotels in the pipeline in this market include a budget hotel and a mid-market property, both of which are being planned by the developers of Ramada.

Yekaterinburg saw a growth in average value of approximately 3% in 2008 owing to an increase in RevPAR (some 6%) and the optimism of the Shanghai Co-operation Organisation Summit, which Yekaterinburg hosted in July 2009. However, despite the Shanghai Summit, the RevPAR fell significantly in 2009.

Considering the high industrial output from the Oblast, which is second only to the Moscow region, but with RevPAR growth threatened by a significant increase in new rooms, we estimate the value per room for hotels in Yekaterinburg in 2009 to be €106,000.

## Kazan, Russia

With a population of just over a million, Kazan is the capital of the Tatarstan Republic. Since its millennium celebration in 2005, the city has transformed itself in terms of local infrastructure and new hotels (Shalyapin Palace Hotel and Korston Hotel). Kazan is an important commercial hub for the local oil and gas industry and for machinery manufacturing. In addition, Kazan has a beautiful city centre with a number of tourist attractions (Kazan Kremlin) and a good sports infrastructure; these attractions induce demand to the market and help weekend occupancies.

Kazan's hotel supply is rather recent and of good quality. The first internationally branded hotel, a 155-room Ibis, opened at the end of 2009. A 151-room Park Inn on Lesgafta Street opened in late 2010. Proposed supply in the city includes a Courtyard by Marriott in 2011. Owing to its strength as a commercial market with the potential for a more balanced business mix, we consider that Kazan will establish itself as a major secondary market in Russia.

With a fairly average RevPAR performance owing to a lack of branded supply and with limited new supply expected to enter the market, we estimate an indicative hotel value per room for Kazan of €102,000.

## Rostov-on-Don, Russia

As the capital of the Southern Federal District, Rostov-on-Don attracted investor interest early on. With 1.1 million inhabitants and its location on the river Don, the city is a commercial and transport hub.

The city's first internationally branded hotel, the 81-room Radisson Don, opened in April 2008. While the market's fundamentals are sound, the large hotel pipeline in the upscale segment causes concern: a Hyatt, a second Radisson and a Kempinski (totalling 1,000 rooms) are planned for the city over the next few years. In addition, a 260-room Sheraton is currently scheduled to open in mid-2012. Oversupply could impact the hotels' ability to grow average rates in the future. However, potential still exists in this market for the development of budget and mid-market hotels. We are also aware of plans to build a Holiday Inn in the city by 2011.

In addition, the government plans to create a resort and holiday zone near the Sea of Azov over the next five years. Rostov is also one of the four areas where gaming will be permitted.

Rostov-on-Don hotels saw modest RevPAR growth in 2008 despite the opening of the Radisson. However, RevPAR fell significantly in 2009 as the commercial segment reduced travel budgets.

As a city with a strong historical performance but a risk of oversupply, we have put the city's hotels' average value indication at €96,000 per room in 2009.

### Samara, Russia

Samara is a large industrial and transport centre in European Russia. Along with its many industries, Samara is also a major intellectual, cultural and academic centre in Russia with many theatres and museums.

Samara's quality hotel supply includes a 177-room Renaissance, a 196-room Holiday Inn, and a three-star Azimut hotel (96 rooms). A 200-room Ibis is scheduled to open in early 2011.

With poor RevPAR performance owing to the struggling manufacturing industry in Samara and Tolyatti, and a lack of upscale hotels, together with a reasonable outlook for the medium term, we estimate the city's hotels' average value to be €88,000 a room.

### Yerevan, Armenia

Yerevan is Armenia's capital and its largest city; it is also one of the world's oldest continuously inhabited cities. Yerevan is Armenia's industrial and transport centre. As the centre of Armenian culture, Yerevan has a number of museums and theatres, an opera house, a conservatory, several large public libraries, and a university and technical institutes, as well as botanical gardens and zoos.

The key drivers of the local economy are mining, the production of machinery and electrical equipment, rubber products, plastics, chemicals, textiles, processed food and small-scale agricultural products. Arts and crafts, such as carving, pottery and diamond cutting, also support the local economy. The IT and financial services sectors are also starting to develop rapidly, which is confirmed by the presence of many international companies, including KPMG, Gazprom, the World Bank and HSBC. In addition, hotels benefit significantly from overseas Armenians visiting the city following widespread migration from the country.

Yerevan's quality supply includes a Marriott, a Golden Tulip hotel and a Golden Sand hotel. There are also rumours concerning new supply entering the market; however, with the exception of an Ibis hotel, most projects are currently speculative.

Because of low but stable RevPAR performance and limited new supply, we estimate the value for quality hotels in Yerevan to be €85,000 per room. This value seems low because of the modest performance of the local hotel market (except the Marriott hotel) and the lack of upscale hotels.

## *Challenges for the Valuer in the Region*

In developing an opinion of Market Value, a professional firm is charged with the task of reflecting current market conditions and how investors are underwriting their acquisitions. In the current climate, more than ever, the valuer faces a number challenges in the region.

- Lack of transparency in terms of tourism statistics, operational data and sales transactions;
- Lack of relevant long-term (5-10 years) historical market data;
- Opaque owning and financing structures in hotel projects;
- Debt mix of local and international banks needs to be incorporated in the finance assumptions;
- Exchange rate fluctuations;
- Need for a methodology that is widely understood.

The HVS London office has been operating actively in the Russia and the CIS markets over the past ten years and, together with our international experience of valuing hotels, we have accumulated a wealth of information to overcome these obstacles.

## *The Hotel Valuation Methodology*

In evaluating property to assess its Market Value[1], the professional valuer has three approaches from which to select:

- Income capitalisation;
- Cost;
- Sales comparison.

The most relevant of these is income capitalisation. However, the prudent valuer would also consider the cost approach and the sales comparison approach. The cost approach, in certain circumstances, indicates what the 'cost of entry' into the market would be, whereas the sales comparison approach typically provides a range of values per room. Both methodologies have some influence on lender and investor judgement.

[1] *Definition of Market Value: 'the estimated amount for which an asset should exchange on the date of valuation [here, 31 December 2009] between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.'*
– RICS (2008) *Appraisal and Valuation Standards*

The **Income Capitalisation approach** converts the anticipated future benefits of property ownership into an estimate of present value.

This approach is based on the principle that the value of a property is indicated by the net return to the property, or what is also known as the present worth of future benefits. The future benefits of income-producing properties, such as hotels, are net operating income, derived by a forecast of income and expense, and any expected reversionary proceeds from a sale. These future benefits are converted into an indication of value through a capitalisation process and discounted cash flow analysis.

We consider that a ten-year leveraged discounted cash flow is the most accurate method of valuation, provided there is transparency for the valuer to prove the source of all market assumptions and investment parameters. Once we have forecast a hotel's future earnings and identified an optimum capitalisation rate which reflects the risk of owning the hotel over that period, we further assume a sale of the hotel at the end of the ten-year period. We then discount the forecast earnings and the proceeds from the sale to the present value based on the investment parameters and return requirements of equity and debt participants.

This is often selected as the preferred valuation method for income-producing properties because it most closely reflects the investment thinking of knowledgeable buyers.

The **Cost approach** is based on the assumption that an informed purchaser will pay no more for a property than the cost of producing a substitute property with equal utility. This method estimates the value by computing the current cost of replacing a property and subtracting any depreciation resulting from one or more of the following factors: physical deterioration, functional obsolescence and external (or economic) obsolescence. The value of the land, as though it were vacant and available, is then added to the depreciated value of the premises in order to produce an estimate of the total value.

The cost approach may provide a reliable estimate of value for newly constructed properties; however, as buildings and other forms of premises increase in age and begin to deteriorate, the resultant loss in value becomes increasingly difficult to quantify accurately. We find that knowledgeable buyers of hotels generally base their purchase decisions on economic factors such as forecast net operating income and return on investment. Because the cost approach does not reflect any of these income-related considerations, this approach is given minimal weight in the hotel valuation process. This method does, however, provide an estimate of the cost to enter the marketplace and is particularly useful when valuing newer hotels.

Indicative construction costs per room (excluding land) in the region are shown in Table 7 and were provided by international property consultancy Richard Chancellor. The indicative costs for each scale include construction costs, FF&E and specialist equipment, but exclude professional fees and costs associated with land acquisition.

**Table 7 Indicative Construction Costs (€)**

| Countries | Economy | Midscale | Upscale | Upper Upscale |
|---|---|---|---|---|
| Ukraine | 35,000 | 75,000 | 105,000 | 160,000 |
| Kazakhstan | 45,000 | | 135,000 | 190,000 |
| Russia | 60,000 | 90,000 | 115,000 | 155,000 |
| Armenia | | | | 160,000 |
| Azerbaijan | | 80,000 | | |
| Georgia | | 55,000 | 150,000 | 200,000 |

Source: Richard Chancellor, 2010

The **Sales Comparison approach** is based on the assumption that an informed purchaser will pay no more for a property than the cost of acquiring an existing property with equal utility.

This valuation method estimates the value of a property by comparing it to similar properties recently sold on the open market. To obtain a supportable estimate of value, the sales price of a comparable property should be adjusted to reflect any dissimilarity between the comparable property and the hotel.

Table 8, illustrates examples of some of the key recent transactions in the region.

**Table 8 Recent Hotel Transactions in the Region (€)**

| Property | Location | Sale Date | Number of Rooms | Estimated Price | Price Per Room |
|---|---|---|---|---|---|
| Budapest JSC (55% stake) | Moscow | March 2009 | 137* | 45,900,000 | 335,000 |
| Park Inn Ekaterinburg | Ekaterinburg | July 2008 | 160 | 22,500,000 | 141,000 |
| The Sadovaya Hotel | St Petersburg | January 2008 | 70 | 7,000,000 | 100,000 |
| Iris Congress Hotel (50% stake) | Moscow | October 2007 | 98* | 43,800,000 | 438,000 |
| Sheraton Metechi Palace Hotel | Tbilisi | June 2007 | 140 | 49,400,000 | 353,000 |

* Pro rated room count based on stake percentage acquired.

Source: HVS Research – Selected Transactions

## *Conclusion and Outlook*

Both at the regional average level and at an individual market level, 2009 has been another difficult year for Russia, the CIS and Georgia.

Falling RevPAR across the region and the increased risk of conducting business in emerging markets during an economic crisis made 2009 a challenging year for the region. The subsequent fall in euro values per room was compounded by the devaluation of many local currencies.

As we approach the fourth quarter of 2010, we note that some markets have started seeing a recovery in trading performance. Moscow and St Petersburg hotels have reported an increase in occupancy, although at the expense of average rate, but still enough to report a positive RevPAR when compared to the same period in 2009. Furthermore, the rouble has also started to strengthen against the euro, which should further boost 2010 hotel RevPAR in the region.

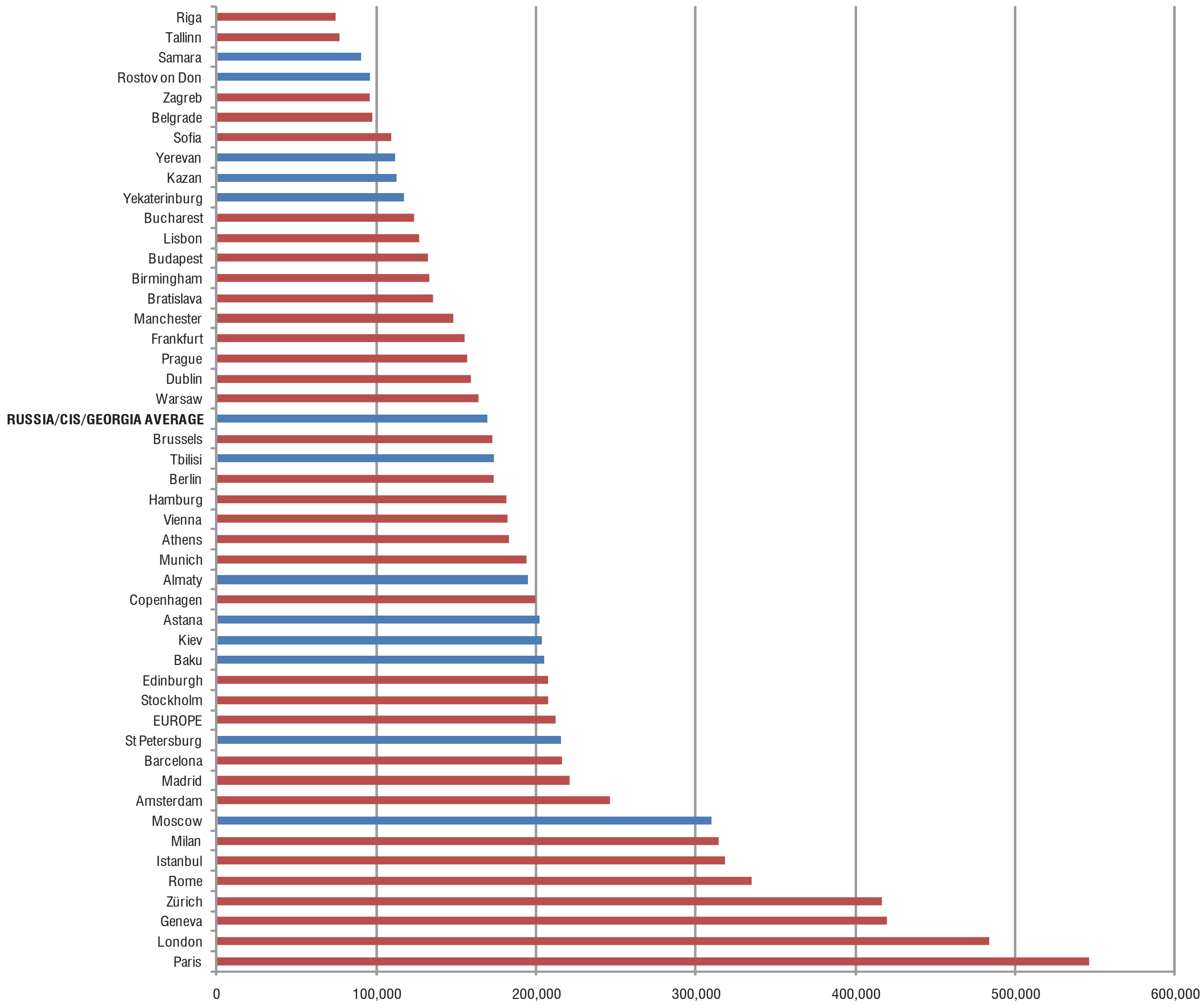
Only once a sustainable turnaround in trading performance has been achieved are we likely to see an improvement in the availability and cost of capital, which is also strongly correlated to the risk factors associated with a particular market.

Given what we have seen so far in 2010, we are hopeful of providing a more positive portrait of hotel valuations for this region next year, at least for some markets.

-END-

*Note: This publication serves as a value indicator only in order to provide a point of orientation for owners and investors. As experienced with the European HVI, this publication's reliability increases as more and more hotels contribute their data and the markets reach a greater degree of stability. No investment decision should be based solely on the information contained in this article. For feasibility studies, valuations and strategic advice, please contact Elke Geieregger or Saurabh Chawla.*

**Table 9 Russia, the CIS and Georgia/European HVI Value Comparison 2009 (€)**



# About the Authors

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# About HVS

HVS is the world's leading consulting and services organisation focused on the hotel, restaurant, shared ownership, gaming and leisure industries. Established in 1980, the company offers a comprehensive scope of services and specialised industry expertise to help you enhance the economic returns and value of your hospitality assets.

Because hotels represent both real property and operating businesses, the founding partners of HVS decided to develop the first comprehensive valuation methodology for appraising these specialised assets. Their initial textbook on this topic entitled *The Valuation of Hotels and Motels*, published by the Appraisal Institute, created the industry standard for valuing hotels and is now used by virtually every appraiser around the world. HVS continues to be at the forefront of hotel valuation methodology, having published six textbooks and hundreds of articles on this subject, which are used in appraisal courses and seminars and at leading hotel schools such as Lausanne, IMHI and Cornell. HVS associates are constantly called upon to teach this methodology to hotel owners, lenders and operators and to participate at industry conferences. HVS principals literally 'wrote the book' on hotel valuation, which significantly enhances the credibility and reliability of our conclusions.

Over the past three decades, HVS has expanded both its range of services and its geographical boundaries. The company's global reach, through a network of 30 offices staffed by 400 seasoned industry professionals, gives you access to an unparalleled range of complementary services for the hospitality industry:

Consulting & Valuation
Investment Banking
Asset Management & Advisory
Shared Ownership Services
Golf Services
Executive Search
Risk Management
Property Tax Services
Convention, Sports & Entertainment Facilities
Interior Design
Sales & Marketing Services
Hotel Management (US only)
Eco Services
Food & Beverage Services
Gaming Services
Hotel Parking Consulting

Our clients include prominent hotel owners, lending institutions, international hotel companies, management entities, governmental agencies, and law and accounting firms from North America, Europe, Asia, Latin America and the Caribbean. HVS principals are regarded as the leading professionals in their respective regions of the globe. We are client driven, entrepreneurial and dedicated to providing the best advice and services in a timely and cost-efficient manner. HVS employees continue to be industry leaders, consistently generating a wide variety of articles, studies, and publications on all aspects of the hospitality industry.

HVS is the industry's primary source of hotel ownership data. Our 2,000+ assignments each year keep us at the forefront of trends and knowledge regarding information on financial operating results, management contracts, franchise agreements, compensation programmes, financing structures and transactions. With access to our industry intelligence and data, you will have the most timely information and the best tools available to make critical decisions about your hospitality assets.

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