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MARKET OVERVIEW

Hotel industry in Russia

The hotel industry is expected to become one of the most dynamic sectors in Russia, for two major reasons:

- **1. Tourism to Russia is increasing at a very fast pace.**

Russia currently receives up to 40 million tourists per year,[1] and this number is anticipated to rise in both its domestic and foreign component. According to Moscow City Government estimates, the current number of tourists visiting Moscow is around 2.9 million per year, and this is estimated to reach 5 million within the next decade. By comparison, Berlin attracts 3.2 million, Vienna 2.8 million, and London 18 million.[2] Furthermore, by year 2020, Russia is expected to be among the 10 top most visited countries in the world, attracting 3 percent of the world's tourist market. This trend is confirmed by figures for the first quarter of this year (2007) when tourism has increased by 20 percent.[3]

- **2. The industry is still modest in size compared to that of Western countries, and it has not developed homogeneously.**

While in the '90s Moscow and a few other cities in Russia experienced tremendous growth in the upper tier of the hotel market, now this sector is close to saturation. The concentration in the expensive five-star hotel market limits the alternatives for tourists and business people, who usually look for lower prices while still expecting Western security and comfort standards.[4]

Demand is fast outpacing the meager supply, with the hotel industry unable to accommodate about 30-50 percent of in-bound travelers, according to the Russian Union of Tourist Industry.[5] Moscow alone needs to double its hotel capacity by 2010, while the current demand for quality hotel space in Saint Petersburg is 30,000 beds in addition to the 30,000 existing beds.[6]

1 U.S. & Foreign commercial services. Hotel and Resort Development in Russia, 07/2004.
2 Moscow Tourism Enjoys Jump. May, 10, 2007. Available on -line at: http://www.mnweekly.ru/news/20070510/55243723.html
3 Ibid.
4 Cohen, Amon; Buyers Devise Strategies To Secure Hotel Rooms In European Capitals, May 7, 2007. http://www.btnmag.com/businesstravelnews/headlines/global_display.jsp?vnu_content_id=1003581555
5 http://www.gvasawyer.com/v2/press.asp?WCI=26
6 U.S. & Foreign commercial services. Hotel and Resort Development in Russia, 07/2004.

Opportunities:

Some experts estimate the Russian hotel market at 2 billion dollars a year.[7] The highest level of unfulfilled demand is for quality three star and economy hotels. To date, the market of mid-tier and budget hotels has not developed to satisfy the demand of both Russian and foreign middle-class business travelers and an ever increasing number of tourists. Part of the clientele that stays at upscale hotels would move to less expensive properties if supply were offered.

The middle class and economy class hotel niche offers the most promising perspectives throughout Russia and it is expected to boom in the next several years. This is due also to the fact that some of the old Soviet-time hotels have either already been demolished or closed, thus significantly decreasing Moscow's total room stock.[8] Reduction in the mid-range due to the elimination of old room stock is not compensated by new hotel supply additions.[9] Mid-priced U.S. hotel chains have an excellent reputation with Russian business travelers and will undoubtedly find a market in Russia's major cities and resort towns.[10]

Long-term residence accommodations:

Together with three-star and economy hotels, there is also a gap in the market for long-term residence accommodations. This form of accommodation is needed as moderate price alternative to long term expensive hotel stays, in particular for foreign businessmen. According to an expert opinion, about 250,000 foreign business people are permanently working or on extended stays in Moscow.[11]

7 Ibid.
8 Hotel Market Overview, Jones Lang La Salle Hotels, 2005.
9 Russia Real Estate Review, Colliers International, 2007.
10 U.S. & Foreign commercial services. Hotel and Resort Development in Russia, 07/2004.
11 Ibid.

Moscow hotel market

The Moscow hotel market is comprised of approximately 175 hotels able to accommodate about 72,000 guests. Most of the currently available rooms though are old Soviet-style properties and it is estimated that only 5,000 rooms are now able to meet Western standards. According to the city's long-term plan for hotel development the number of beds will increase to 200,000 by 2010, about 40 percent of which will be in the two- and three-star classification.[12]

Moscow hotels can be divided into two major groups: Western-style and Soviet-style hotels.

Western-style Hotels
Among the 175 hotels presently open in Moscow, no more than 30 offer Western-style accomodation. These properties are distributed among upper-tier class, mid-tier and economy. Most of them are concentrated within the center of the city (Central Administrative District), and the majority falls into the 4 or 5 star category. Most of these hotels were built between 1992 and 1996, and they are located near the Kremlin or Tverskaya Street, which connects the Red Square and the Sheremetievo International Airport. Though this segment is almost saturated, they maintain occupancy levels greater than 70 percent, compared to the average 64 percent in the U.S.[13] Currently, the hotels in highest demand are the small and budget properties. This segment includes three-star small hotels providing quality service[14] (currently less than 10 percent of the market) and 1–2-star budget hotels.[15] While occupancy rates in three-star hotels are almost the same as in the upper-tier, occupancy rates in the budget category are over 80 percent.[16] Despite the fact that this segment underwent the highest rate of growth in average prices, these hotels remain the most affordable tourist accommodation in Moscow and therefore have no difficulty reaching close to full occupancy.[17]

Mid-range Soviet-style Hotels
This group consists of Soviet-era three- or four-star hotels (according to Soviet standards, which are significantly lower than in the West) that have independent management. They are mainly concentrated in the North-East Administrative District and in the Central Administrative District. The occupancy level for three-star hotels in 2006 was stable at 72.5 percent. They are heavily deteriorated, poorly equipped (furniture, appliances, utilities) and the quality of service does not meet Western standards accepted for this category of establishments.

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12 U.S. & Foreign commercial services. Hotel and Resort Development in Russia, 07/2004.
13 David Eisen, “PKF: Hotel Occupancy To Dip In 2007.” Available on-line at:
http://www.btnmag.com/businesstravelnews/headlines/hotel_display.jsp?vnu_content_id=1002914981
14 Ibid.
15 Among most successful and recognized small hotels are the Savoy, Katerina, Best-Western, Park Hotel, Danilovsky Hotel, Traveler's Guest House, Alrosa na Kazachyem, Sretenskaya, Sedmoi Etazh, Pallada, and recently added Aquarel, and Tiflis. In the majority of cases these are private or corporate hotels, or belong to various federal entities.
16 Ibid.
17 Russia Real Estate Review, Colliers International, 2007.

St. Petersburg hotel market

St. Petersburg offers tremendous hotel development and opportunities. The city is Russia's cultural capital and is known as one of the most popular tourist destinations in the world. The majority of foreign visitors come from Finland, followed by the USA, Germany, France, and Italy, staying on average 3.5 days and spending approximately $150 per day. In addition to international visitors, one million domestic travelers visited St Petersburg in 2004, up from 800,000 in 2003, staying on average two days and spending $70 per day.

Overall St Petersburg has 180 hotels, with the current demand for quality hotel space being 30,000 beds in addition to the 30,000 existing beds.[18] In comparison to other world-renowned destinations such as Prague and Vienna, St. Petersburg has a modest supply of hotels.

Currently, St. Petersburg has nine internationally managed hotels, most of them within the upscale and luxury segment, located in the city centre in the vicinity of St. Isaac's Cathedral or along Nevsky Prospect. The largest share of the new supply, which has entered the market over recent years, is in the small-scale segment, comprising independent, privately held properties with fewer than 50 rooms and limited facilities.

Opportunities:

While the high-end sector is close to saturation, there is a strong demand for mid-level hotel rooms. The fastest growing real estate sub-sector is the small hotel (approx. 20 rooms) category. Local tourism officials and business analysts believe that even faster growth is limited only by the undeveloped tourism infrastructure, especially the inadequate number of quality, moderately priced, hotel rooms.[19]

In 2003, twenty new small hotels were opened and in 2004 the total number of such properties in St. Petersburg was between 60 and 70, with approximately 1,400 new rooms. Analysts believe that the small hotel market has great potential and expect continued growth in the next years.

18 Ibid.
19 U.S. & Foreign commercial services. Hotel and Resort Development in Russia, 07/2004.

Regional development

Market experts indicate that the Russian hotel market is undergoing a decentralization process, focusing attention on: Black Sea resorts in the Krasnodar region, the Golden Ring of Russia and regional capitals, such as Nizhny Novgorod, Samara, Yekaterinburg, Novosibirsk and Kaliningrad.[20]

To meet the demand, 15 to 20 three-star hotels of 70-100 rooms should be built in each of the above mentioned popular tourist areas. Average construction cost of one hotel is about 5-20 million dollars. [21] Russian-managed non-branded hotels are making the greatest inroads on the market in the regions. They are catering to the demands of the emerging middle class, which has become accustomed to Western service standards. "The regions offer less red tape and swifter market penetration [compared to Moscow]."[22]

Krasnodar region:
Primarily due to its geographical and economic position, the region has attracted significant investment from a number of foreign and large Russian companies. The recent (July 4th, 2007) designation of the Russian city of Sochi as the hosting location for the 2014 Winter Olympic Games has already drawn the attention of international investors. At least 25,000 new hotel rooms (and as many as 44,000, according to some experts) need to be built in the next few years.[23] According to David Jenkins, Director of Horwath HTL, "It is definitely a boom time in Sochi, which will also help develop other Russian Black Sea resorts such as Anapa and Gelendzhik. There is no turning back now."[24]

Opportunities:

With Western hotel brands still absent in virtually all of Russia's regional cities, it does not take much to become the destination of choice for quality-conscious travelers. According to Collier International, "unless global brands enter the market now, they will probably find that they have very strong competition." "If you build a Western-standard mid-market hotel in any of those regional cities, it will be the best hotel in town." "You don't have to spend $200,000 per room to be the best hotel; you can spend $100,000 and still be No. 1." [25]

20 Lysenko, "The future for Regional Hotels." Available on-line at: http://www.realestate.moscowtimes.ru/homeeditions/quarterly/75
21 U.S. & Foreign commercial services. Hotel and Resort Development in Russia, 07/2004.
22 http://www.gvasawyer.com/v2/press.asp?WCI=26
23 "Facts and Figures – Sochi 2014." Available on-line at: http://sochi2014.com/36870
24 "Hotels are getting hot in Sochi." E-hotelier.com, July 3, 2007. Available on-line at: http://ehotelier.com/browse/news_item.php?id=P11435
25 http://www.gvasawyer.com/v2/press.asp?WCI=26