

# Market Outlook

## Hotels Report 2010

February 2011

### CBRE Hotels Activity

- Sale of the Tryp Ambassador Hotel, located in Madrid, advising Royal Urbis on the sale
- Operator search for the Condal Mar Hotel, owned by Acciona Inmobiliaria, choosing Sol Meliá via its Tryp by Wyndham brand
- Operator search for two luxury hotels in the Isla de Extremadura, in Cáceres, selecting Husa as the operator
- Operator search for the Hostal Cantábrico in Madrid, signing with the low-cost hotel chain Equity Point

### Key points for 2011

- In terms of trading, we hope that RevPAR in 2011 will continue to improve in the majority of Spanish markets, although all increases are expected to be moderate due to the low prices which we have continued to see over this year. In addition, we will continue to observe more variable rents being signed, as well as more management and franchise agreements and in investment we will observe a moderate upturn due to an increase in the rotation of hotel properties.

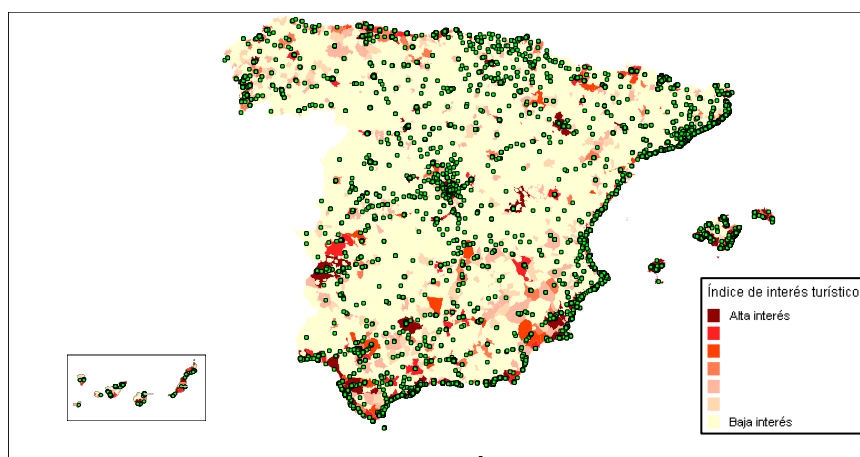


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### SUMMARY

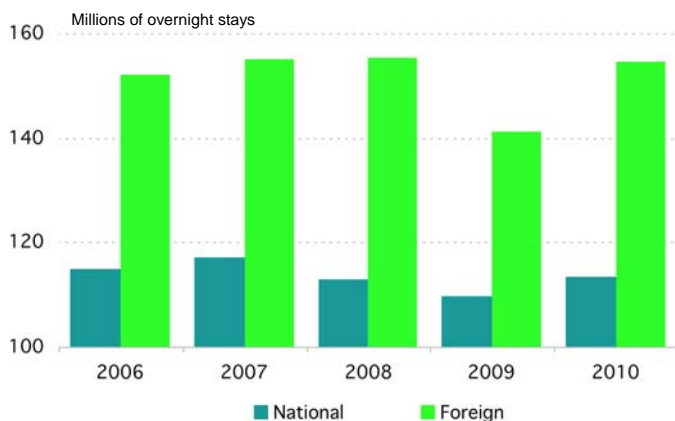
- ✓ The hotel sector in Spain's main cities is in a phase of stable and slow recovery. Demand, which primarily comes from foreign visitors, is breaking all records, leaving the falls of the past few years behind. The recovery in demand, is happening both in the tourism and corporate sectors. In certain Spanish markets, this demand is coming at the expense of a fall in average prices. Despite this, the operating results in terms of hotel income and profitability, have improved compared to 2009, allowing the sector to see the first green shoots of recovery.
- ✓ The upturn in demand is accompanied by forecasts of moderate increases in supply. The main reasons for postponements and cancellations of new hotel openings is the uncertainty and the difficulty of acquiring financing. This has meant that there is more of a balance between supply and demand. However, and despite this, investor's heightened sensitivity to current prices means that this growth will slow and will also provide sustainable values over time.
- ✓ Investment volumes in the hotel sector have remained stable in 2010 compared to the previous year, a positive factor taking in to consideration the 15% fall in tertiary investment in the Spanish real estate sector over this period. However, the lack of adequate supply is a common factor in all sectors. The main active investors are mainly looking for prime properties which offer a high level of income security. There are also opportunistic investors who are willing to look at less prime properties, but the high level of risk has to be reflected in the purchase price in order to close a deal.

### Hotels and tourist areas in Spain



Source: CB Richard Ellis, created using data from Pitney Bowes Business Insight report and La Caixa's 2010 Annual Economic Study

**Overnight stays in Spain**



Source: INE

**The sector is stabilising**

In 2010 Spain registered a total of 268 million overnight stays, which is 6.8% more than in 2009, and brings figures back up to similar levels seen in 2008. This improvement was primarily thanks to the recovery in foreign demand, which increased by 9.5% compared to the previous year. In 2010 significant increases were registered in terms of the number of overnight stays by the British (+6.4) and German (+5.7%) markets, which made up more than half of the foreigner overnight stays in hotels in Spain. Other markets of lesser importance in terms of volume, but which have a higher average spend, increased their overnight stays in Spain in a larger proportion, such as Russia (+44.7%), USA (+17.3%) and Japan (+16.1%). This upturn in demand in 2010 has meant that, for the first time in the last ten years, tourist sector growth (+1.0%) has been above Spanish economic growth (-0.2%).

**Growth in urban areas**

The increase in demand both in terms of the domestic market as well as the foreign market was higher in urban areas than in holiday destinations.

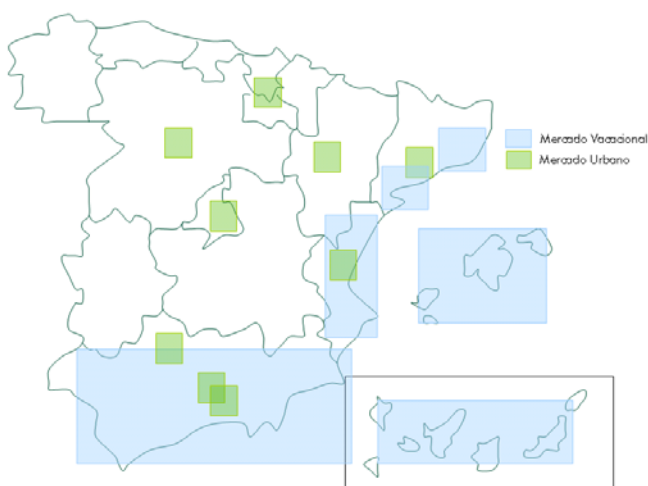
The number of tourists at Spain's coastal destinations did not improve as expected: the Canary Islands was one of the few places in Spain that saw above average growth, whilst other destinations such as the Balearic Islands, Costa Brava and Costa Blanca had a slight increase in overnight stays. The Costa del Sol was the only notable holiday destination where the number of overnight stays decreased compared to 2009.

In addition, Madrid and Barcelona registered record numbers of visitors and overnight stays in 2010. Other cities such as Bilbao, Seville and Valencia have seen a recovery in overnight stays similar to those seen before the crisis. In Madrid, an increase in the number of leisure trips, along with the fact that several prestigious international events were held there, as well as the fact that there has been a slight recovery in corporate activity, has meant that there has been more demand than ever seen before, this has been a welcome breath of fresh air for hoteliers in the city.

7.87 million visitors travelled to the capital in 2010, which is 9.0% more than in 2009. The number of overnight stays increased by 10.7% more than in 2009 and 7.4% more than the previous maximum of of 15 million registered in 2007. Furthermore, the average stay per visitor rose by 1.7% to reach an average of 1.94 days.

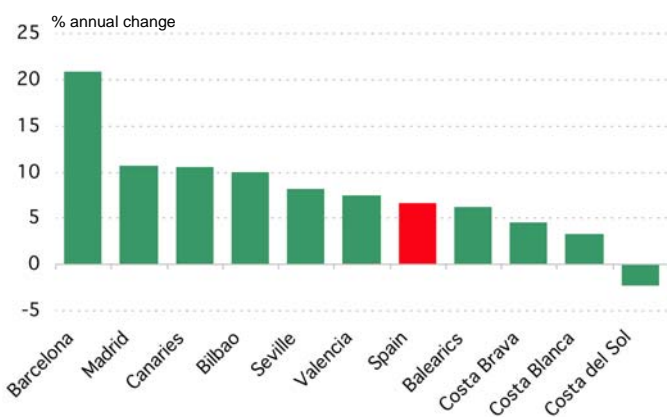
The increase in the number of passengers did not solely come from Barajas airport, which did register an increase

**Main tourist areas in Spain**



Source: CB Richard Ellis

**Growth in overnight stays in the main areas**



Source: INE

of 3.2% in the number of passengers compared to 2009. The smaller increase has been primarily due to travellers using alternative transport, such as the train, especially the AVE high-speed train.

**Anti-cyclical factors**

Barcelona attracts a considerable amount of leisure market and is a very strong “city break” destination, which along with demand from the business and MICE sector seems to have a non-seasonal effect in comparison with overnight stay demand in Madrid. The fact that Barcelona is more focused on the foreign market (78% of its overnight stays are from foreigners compared to 54% in Madrid), has meant that it has increased the number of hotel nights sold in 2010 by 20.75% to 15.1 million overnight stays and for the first time in history almost reached the same annual volume achieved in Madrid.

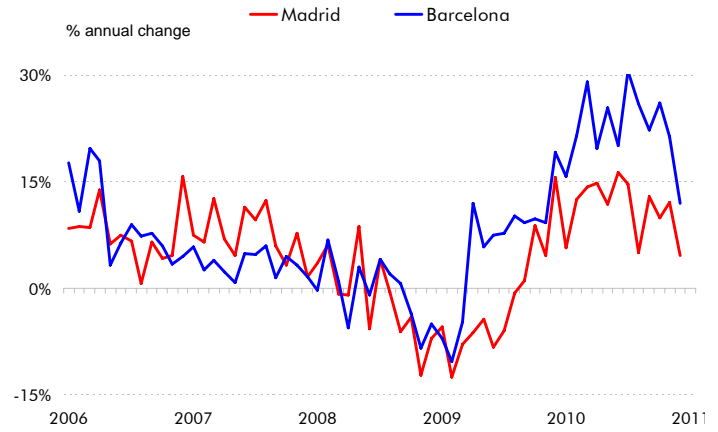
The average stay in Barcelona has increased over the last three years by 6.8%, with the average in 2010 reaching 2.34 days, which is higher than Madrid. This is due to the climate, which attracts more people in the months of July and August and those visitors stay longer.

When it comes to which category of hotel travellers choose in Madrid and Barcelona, there are more overnight stays in 4\* hotels in Madrid than in Barcelona, and viceversa in terms of 3\* hotels. The reason for this is down to the reason for the trip in each city: i.e. Corporate in Madrid and leisure in Barcelona.

**More variety in categories**

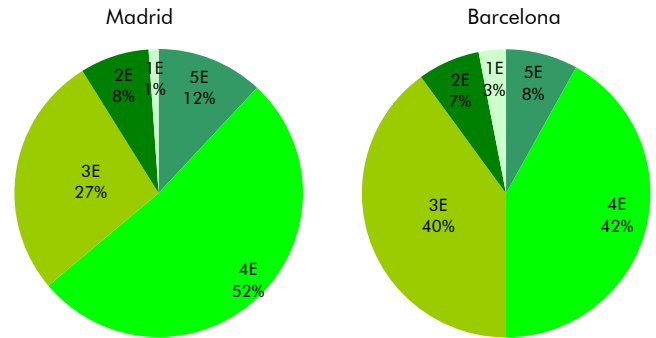
According to INE figures, hotel stock in Spain increased by 2.4% in 2010 compared to 2009, which is below the last 5 year average growth rate of 3%. The difficulty of acquiring financing for new projects over the past two years is beginning to be reflected in a decrease in supply coming on to the market. In terms of the make up of the national hotel market, 4\* and 3\* categories make up almost 80% of all stock (41% and 38% respectively), followed by 2\* hotels with 11% and 5\* with 6%. Hotel stock in Madrid is primarily comprised of 4\* hotels: 54% of all supply. However, the proportion of 4\* hotels has decreased slightly since 2000 given that developers have attempted to diversify and balance out supply in the city. This year, supply grew by 3% in Madrid,

**Overnight Stays**



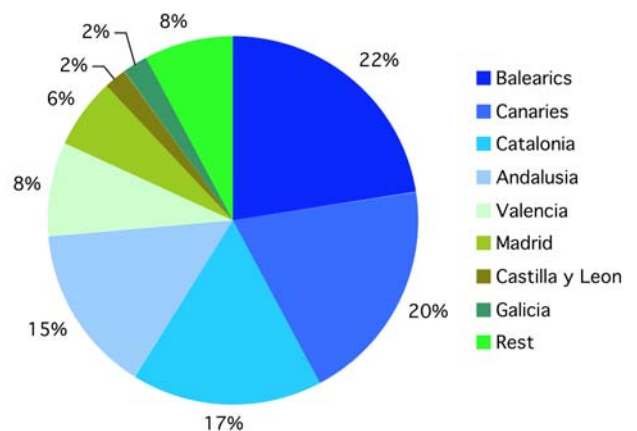
Source: INE

**Division of overnight stays by category - 2009**



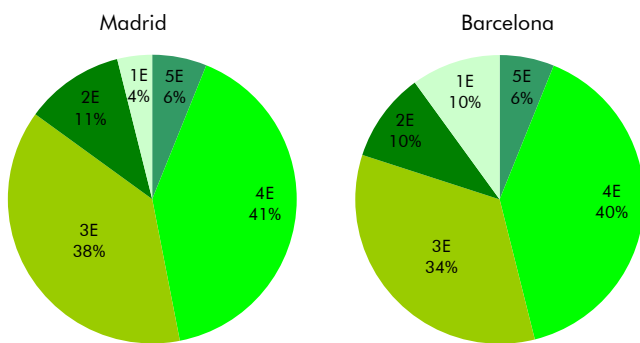
Source: INE

**Distribution of hotel supply by main regions**



Source: INE

### Distribution of hotel supply by category

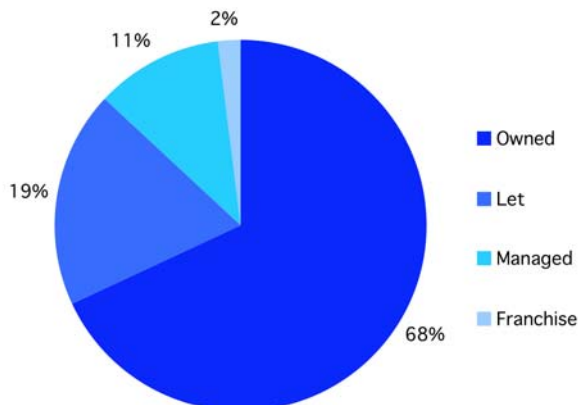


Source: INE

City	Hotel	Chain	Cat.
MAD	NH Ribera de Manzanares	NH Hoteles	4*
MAD	Catalonia Atocha	Catalonia Hoteles	4*
MAD	Etap vallecas	Accor Hotels	3*
MAD	Ibis Ventas	Accor Hotels	3*
MAD	Petit Palace Alfonso XII	High Tech	4*
MAD	NH Palacio Mejia Lejerica	NH Hoteles	4*
MAD	Sidorme Barajas	Grupo Sidorme	2*
MAD	Sidorme Leganes	Grupo Sidorme	2*
MAD	Indigo Madrid	IHG	5*
MAD	Petit Palace Santa Barbara	High Tech	4*
MAD	Castellana 200	Rafael Hoteles	5*
BCN	Alma Barcelona	Alma Hoteles	5*
BCN	Ohla Hotel	Aqua Hotels	5*
BCN	Arai	Derby Hotels C.	4*
BCN	Catalonia Plaza Europa	Catalonia Hoteles	4*
BCN	Inside Barcelona	Sol Meliá	4*
BCN	Travelodge Villa Olímpica	Travelodge	1*
BCN	Vincci	Vincci Hoteles	4*

Source: CB Richard Ellis

### Type of tenancy – hotel chains



Source: Hostelmarket

which is also below the last 5 year average of 4.3%. Of the 7 hotels opened this year, 6 have been 4\* and one 5\*. 12 new hotels are expected to be opened in the city in the period up to 2012, with 1,425 new rooms coming on to the Madrid hotel market.

In terms of Barcelona, 2010 was the lowest year for supply over the past few years, with the number of hotel rooms increasing by 2.7%, reaching slightly more than 31,000 rooms. The city currently has 31,776 rooms spread over 328 hotels. The 4\* and 3\* categories dominate the market with more than 75% of the market (50.96% and 24.99% respectively). Between 2007 and 2010 the hotel category that has seen the highest amount of growth has been 4\* hotels (5.33%). More recently, in 2010 the supply of 3\* hotels has increased by 5.57%. In terms of the future pipeline, hotel supply in Barcelona is expected to increase by 21 hotels and 1,961 rooms up to the end of 2012, 47% of those being 4\* hotels.

### A very fragmented market

When it comes to supply, the Spanish hotel market is very fragmented, with the 5 largest operators controlling only 11% of the market. In total, 66.6% of supply is in the hands of hotel chains and the remaining 33.4% are independent hotels. Sol Meliá Hotels & Resorts is the main hotel group with 3.54% of supply by rooms, followed by NH Hoteles with 2.71%. In Madrid, hotel chains are slightly more prevalent than the national average with 79% of the market. This figure rises to 82.5% in Barcelona and only 10.4% of these are foreign hotel chains. Leaving independent supply to one side, the ownership model continues to be the prevalent control model for hotel groups. Of the more than 520,000 rooms in the hands of hotel chains, 68% are owned by them.

### Better results in Europe as a whole

The market outlook in Europe clearly improved over 2010. According to a study carried out by STR Global, the 20 main European markets saw an increase in their average occupancy rates. In addition to this, more than half of them have managed to increase their average prices. The main capital cities such as London, Paris and Berlin saw average price increases of 8.8%, 5.4% and 8.9% respectively.

As a result of higher occupancy levels, and in many cases an increase in the average price of rooms, the average RevPAR in 2010 has improved in almost all of the main European capital cities with the exception of Bratislava (-12.60%), Bucharest (-2.72%) and Dublin (-2.50%).

### More demand but at lower prices

When it comes to average daily rates, Spain has been different. Although average occupancy has increased by 3.8%, average prices have fallen by an average of 2.2%. This price fall has happened in almost all autonomous communities, with Catalonia posting the most significant fall. In a more competitive sector, operators have had to employ ever more aggressive strategies in order to attract guests and an increase in average occupancy has happened at the expense of lower prices. However, the cities of Madrid and Barcelona have seen an increase in RevPAR of 8.3% and 10.7% respectively. In terms of Madrid, the improvement in RevPAR happened despite a fall of 2.1% in average prices to 89.56 euros. The average occupancy in Madrid hotels in 2010 was 63.6%, which is 10.6% more than in 2009, although average price figures have still not taken off, due to the much more severe fall in 2009 (-17.5%). However the price reductions had their desired effect and revenue per available room (RevPAR) increased reaching 56.95 euros.

The average occupancy rate in Barcelona in 2010 was 67.2%, which is 8.1% higher than in 2009 and along with the 2.3% price increase to 112.75 euros, has generated a RevPAR of 75.79 euros.

### Investors focus on prime product

The volume of hotel transactions carried out in 2010 was practically the same as the year before, amounting to 475 million euros, despite the fact that the year closed with 8 transactions less than the 29 posted in 2009. The main strategy in hotel investment has been focused on core transactions, very prime properties, financially sound tenants and fixed rents. One of the most notable aspects on investment in 2010 was the shift in demand towards higher category hotels. 5\* hotels made up 29% of investment over 2010 and only 14% in 2009. Furthermore, investment in urban hotels has dominated the market making up 71% of all investment, compared with 50% in 2009. As a result of the aforementioned, the average sales price per room rose by 20.5 % to 143,260 euros/room, reflecting the improved quality of the properties and not a general increase in the value of the hotels.

### Change in occupancy and ADR by Aut. Comm

	Occupancy	Average Daily Rate
Spain	3,80%	-2,19%
Andalusía	0,83%	-1,95%
Aragón	2,09%	-3,61%
Asturias	1,64%	-2,59%
Balearics	5,07%	-1,70%
Canaries	5,67%	-2,90%
Cantabria	-0,91%	-1,72%
Castilla y León	-0,17%	-2,16%
Castilla-La Mancha	-3,82%	-2,40%
Catalonia	2,92%	-8,83%
Valencia	2,89%	-2,03%
Extremadura	-1,73%	-3,58%
Galicia	9,26%	1,37%
Madrid	8,58%	-4,02%
Murcia	3,19%	-5,94%
Navarra	0,30%	-1,78%
Basque Country	2,97%	-2,05%
Rioja	-0,23%	-2,67%
Ceuta	14,35%	8,42%
Melilla	-7,20%	-5,85%

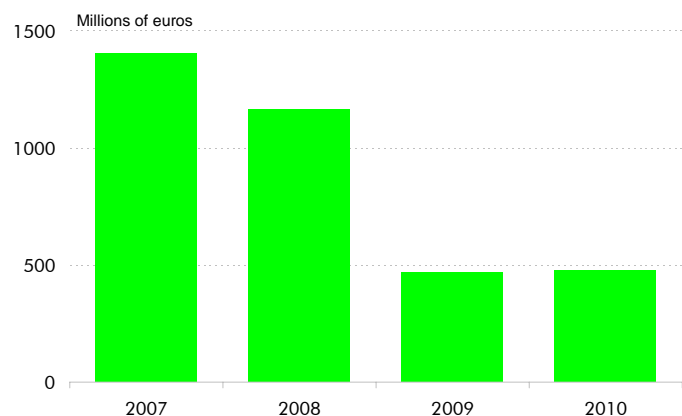
Source: INE

### RevPAR in some European cities

	2010	% annual change
Amsterdam	89.64	17.28%
Barcelona	75.79	10.69%
Berlin	60.22	11.47%
Bratislava	29.73	-12.60%
Brussels	71.85	9.51%
Bucharest	163.64	-2.72%
Budapest	36.80	0.09%
Dublin	53.00	-2.50%
Dusseldorf	63.05	25.06%
Florence	88.96	12.84%
Frankfurt	74.02	21.32%
Hamburg	71.24	11.11%
London	120.69	11.35%
Madrid	56.95	8.32%
Milan	81.16	4.09%
Paris	272.94	11.34%
Prague	45.93	0.61%
Rome	92.38	7.94%
Venice	144.23	4.29%
Vienna	66.70	7.18%

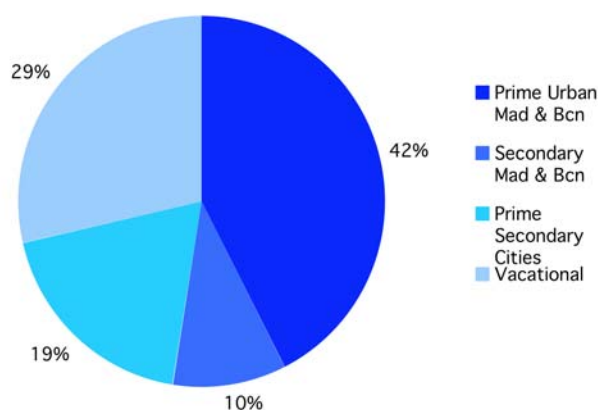
Source: STR Global

### Hotel transaction volumes



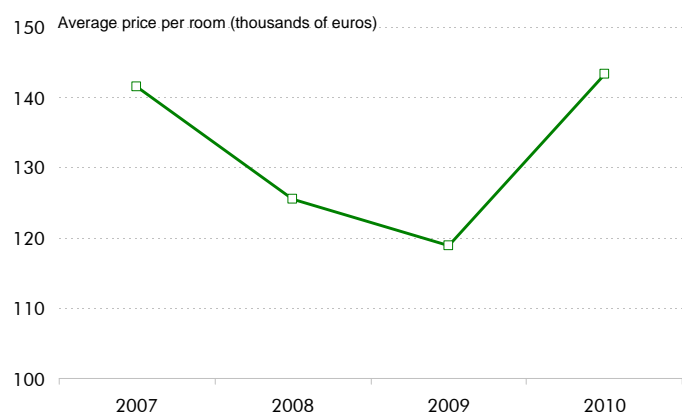
Source: CB Richard Ellis

### Type of Transaction 2010



Source: CB Richard Ellis

### Prices



Source: CB Richard Ellis

Generally speaking, the yields required by investors have stabilised over 2010 compared to 2009 and if anything should be pointed out, it is that a rift has opened up between the yields required for prime and secondary properties due to the growing and strong levels of interest for the first. The search for investment security has been demonstrated by a higher number of sale & leaseback transactions, both in terms of purchases as well as sales, with the properties continuing to be leased by their tenants. Examples of chains that have carried out these types of disinvestments in Spain are Sol Meliá, Hotusa and Abba Hoteles. We should point out that Abba Hoteles has carried out this type of transaction in London and NH Hoteles has also disinvested properties outside of Spain, although these sales have been in sale & managebacks or vacant possession formats.

Aside from investment in prime properties, there are also more opportunistic investors, who are looking for properties owned by financial entities or properties which are undervalued due to their physical attributes or current management, even below their replacement value, so that they can then add value to the property in the future.

The number of hotel projects being bought has decreased significantly due to the preference for buying a cash-flow from the outset. There is only tangible demand for hotel projects in the prime areas of Madrid and Barcelona, with the aim of introducing new supply with international brands and management teams which lack significant presence in the Spanish hotel market. With these groups coming in to the market, which operate on management agreements, not very common in Spain, it is more likely that these agreements will become more widespread in the coming years, as Spanish chains are currently more cautious when it comes to offering fixed rents and therefore the foreign ones can be more competitive.

### More flexible contracts

In many cases, the new contracts signed in 2010 had a considerable variable component in the lease agreements. In addition, a considerable number of management and franchise agreements have been signed, especially in urban properties in secondary locations or in holiday hotels. Generally speaking, fixed rental agreements have not had bank guarantees in place in order to guarantee rental payment and it has become ever more standard to provide a corporate guarantee as a way of offering rental payment security.

However, common sense and the signing of sustainable rents for the hotel and the market to operate on is currently the most viable way of guaranteeing long-lasting contracts.

**Leasing – a financial solution**

It continues to be generally difficult to acquire financing in the real estate sector and even more so for purchasing hotels. This is due to the increased uncertainty with regard to their cash-flows, because there is a trend towards signing variable agreements which means that the lender has to have ‘specialist expertise’, which reduces the number of financial entities which one can sign transactions with.

Over 2010, the sales transactions that have been carried out with the least of difficulty were the ones where the property already had a mortgage and which were flipped on to a new ‘sponsor’ which was accepted by the bank. The quality or previous good relationship of the sponsor with the bank helped these subrogations as well as the fact that part of this debt was paid off with equity.

Lone-to-Value ratios for new debt have been at around 55%-60% and the cost of financing (spreads) has tended to be more expensive, which points to a potential future increase in yields required in order to maintain return objectives.

Real estate leasing and renting have been the main players in many of transactions carried out and this was also the trend in 2009. The models differ from traditional financing in that the owner of the property is the bank, hence, the risks that they can take are more lax, allowing loan-to-value ratios of up to 100% if the property’s cash-flow allows for it. Another factor is the quotas, which are lower due to the deferment of the option, staggered VAT payments and more favourable tax treatment.

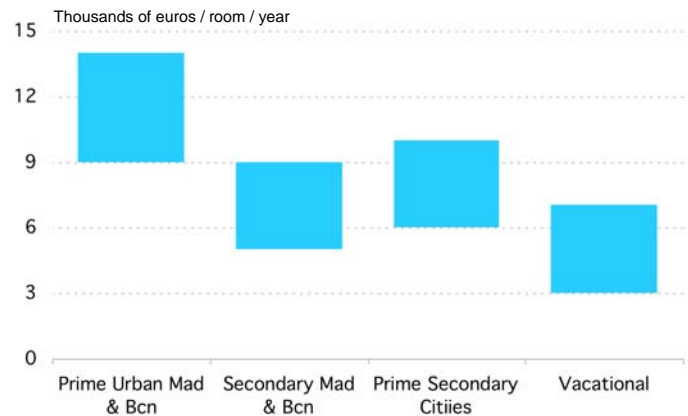
Finally, we would point out that nowadays, the quality and solvency of the tenant, as well as the operating history of the hotel, are very important factors when it comes to acquiring financing for a hotel.

**Main transactions in Spain 2010**

Hotel	Cat.	Rooms	Price M € (Approx)	Buyer	Seller
NH La Maquinista	3*	92	7,5	Grupo Onix	Metrovacesa
Ayre Sevilla	4*	241	N/D	Ayre Hoteles	BBVA Fund
Abba Castilla Plaza	3*	228	32.5	Millenium	Abba Hoteles
Triangulo Princesa	5*	241	90	CPI	Metrovacesa
Los Monteros	4*	172	55	Juda Azuelos	Banif
Sol Pelicanos Ocas	4*	794	74	BBVA Renting	Sol Meliá
Hotel Miramar	5*	75	60	CPI	Area Property
Hotel La Florida	5*	74			
Tryp Ambassador	4*	144	23	Sol Meliá	Reyal Urbis

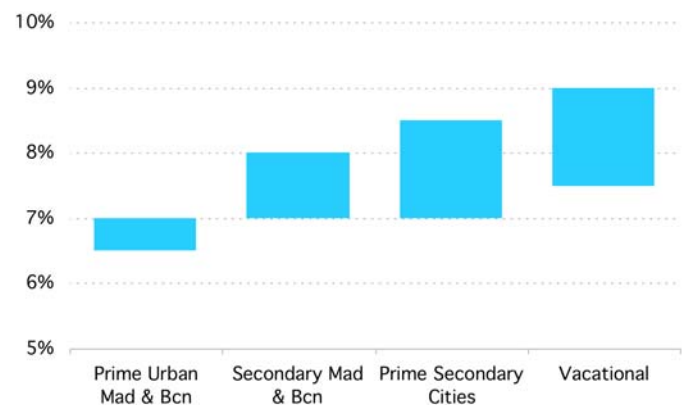
Source: CB Richard Ellis

**Fixed rents**



Source: CB Richard Ellis

**Yields required**



Source: CB Richard Ellis

## Forecasts

✓ It is expected that hotel demand in Spain will continue to improve, above all driven by foreigners. We hope to see the first signs of recovery in average prices in those Spanish markets where occupation is sufficiently high to allow hotels to increase the price without compromising its minimum required return. It is expected that hotels which work with clients in the corporate and MICE sectors could see the first increases in their negotiated rates since 2008.

✓ There is good interest from international hotel chains to move in to the Spanish hotel market, especially in the main Spanish capital cities such as Madrid and Barcelona. We should also point out the potential growth of the “low cost” and “express” hotel sectors, particularly in city centres where they have not been able to develop as much up until now. That said, it is expected that some hotel projects will continue to be postponed due to market uncertainty and the lack of financing.

✓ We expect there to be several operator changes in the market, due to the considerable number of rental agreement renegotiations being required by owners, which are currently unachievable due to the fall in average prices. There is also a growing trend towards management contracts and lease agreements with a high variable rent component. This trend is not only evident in the renegotiation processes but also in the requirements of the main national and international hotel chains. One must also take in to consideration the effect of the new Accounting Regulation which is likely to come in to force in 2013, which stipulates that rents, both fixed as well as variable, will have a financial cost and must be considered as debt on the balance sheet. Once this is in force, it will put even more pressure for hotel lease agreements to stop being the predominant hotel operating contract.

✓ With this change in trend, which makes hotel owners ever more exposed to operational risk, the daily operation of the hotel must be comprehensively monitored, as does the operator’s management of the hotel so that the interests of both parties are in line with each other. Hotel Asset Management is essential for owners who want to monitor and improve the variable returns of their hotels and thereby improve the value of the properties.

✓ In terms of investment, the lack of financing and the imbalance between market demand, which is searching for prime properties, and the current supply of properties which are mostly secondary, could be a barrier to more transactions being signed. In addition, people are hoping that new properties will come on to the market between 2011 and 2012, after the current round of refinancing comes to an end and that the properties that come on to the market will be what investors are currently looking for.

✓ An aggregation of the supply could arise via merger transactions, acquisitions and strategic partnerships. The lack of liquidity, the need to reinvest, the willingness and/or the need for a critical mass increase and/or market share, obtaining synergies and the strengthening of current market positioning make these transaction alternatives, among others, worth considering.

## CB Richard Ellis 2011

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