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 **ERNST & YOUNG**

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Global Hospitality Insights

SPOTLIGHT ON: EUROPE



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From the year-end 2005 results for the European Hospitality market we learned that this market will grow in all but four of approximately 44 European markets. The revenue per available room (RevPAR) growth across Europe was approximately 4% to 5%. Compared to other regions, Europe experienced the lowest growth. However, it still ranks among the highest in terms of overall RevPAR. Europe's best performing region was the Eastern Mediterranean, followed by strong growth in Central and Eastern Europe. The highest RevPARs were reported in Northern Europe.

The terrorist attacks in London on July 7, 2005 did not have a considerable effect on the European hotel market.

The outlook for the year 2006 remains robust barring concerns such as terrorism, natural disasters, and escalating cost of fuel.

RevPAR growth in the European market is expected to be steady rather than substantial, while business demand as well as tourist travel are anticipated to increase.

Where are the major investment opportunities?

The major opportunities for investors in Europe can still be found in the Eastern Mediterranean region, as well as in Central and Eastern Europe. As 10 Eastern European countries recently joined the EU, these areas are anticipated to achieve greater growth rates than the rest of Europe. The Eastern Mediterranean and Central European areas are also becoming attractive travel destinations, particularly for business people.

Which locations are the most desirable?

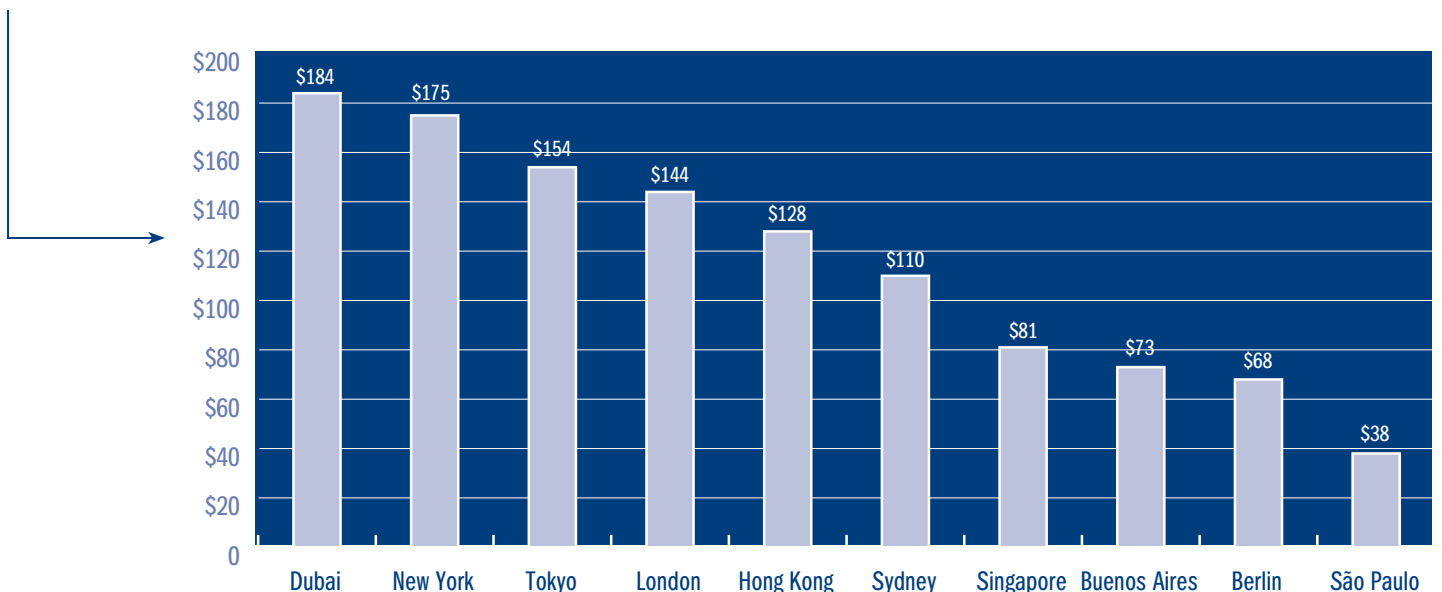
There is constantly high demand for acquisitions in Vienna, Stockholm, and Paris. A lack of hotels in Moscow and St. Petersburg continues to prevail, which could potentially spur further developments. The Moscow Tourism Committee announced in January 2006 that 18 hotels are planned in Moscow during 2006. The plan includes among others four or five Radisson hotels, and one or two Park-Inns.

What development trends do we anticipate this year?

- Investment funds from the U.S. and U.K., including private equity funds, (for example, Blackstone, Whitehall, and Strategic Value Partners) are entering the market with considerable financial resources;
- Hotel chains and U.S. investment funds are trying to win market shares in the European market;
- Big European chains like Accor are very active and dynamic;
- There is increasing interest in REITs as an investment form. REITs are anticipated to be implemented in some European countries in the near future, including Germany, Italy, Luxembourg, the Netherlands, Turkey, and the United Kingdom.
- Due to two major sport events in Europe, i.e. the Olympic Winter Games in Turin, Italy, and the FIFA Soccer World Cup in Germany, the hotel performance is expected to improve in the two countries as they benefit from hosting these major events. ■

2005 RevPAR Performance (in US\$)

Major Global Markets





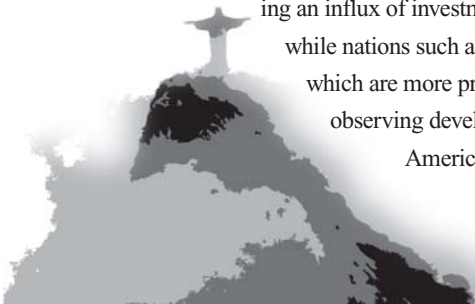
LATIN AMERICA

As Latin American economies continue to stabilize and prosper, nations “south of the border” are generating attractive opportunities for foreign investment in the real estate and hospitality sectors. Latin American powerhouses, such as Mexico, Brazil, and Argentina, have attracted significant foreign investment in the past couple of years and are dominating the mixed-use development arena. Several factors including stronger economies that are less dependent on the influx of foreign capital, controlled inflation rates, and stable – and sometimes appreciating – currency exchange rates, have placed several Latin American countries on the radar screen of European and U.S. investors.

Countries in South America such as Brazil and Argentina are experiencing an influx of investment capital from Europe, while nations such as Mexico and Costa Rica, which are more proximate to the U.S., are observing development capital from North America. This capital is fueling mostly upscale and luxury projects that combine several

uses – residential, lodging, golf – as the presence of additional components reduces investment risk when compared against the development of each use separately. Improving fundamentals (as observed in the large number of retiring baby boomers who are seeking retirement or vacation homes in exotic, yet less-expensive destinations than coastal locations on the U.S. shores) are significantly influencing the proliferation of high-end mixed-use residential developments, where lodging, golf, or marina components serve only as support amenities to get real estate sold.

The preference for branded lodging management companies, signature golf architects, designer beach clubs, and destination restaurants, should remain the norm as investors seek to “protect” their investments by working with operators with proven track records. Given the environment of low capitalization rates and high valuations currently present in the U.S., it is anticipated that in the near term Latin American countries will continue to experience the influx of foreign capital seeking development opportunities with higher yields. However, investors should be cautious about shifting political conditions in Latin America resulting from upcoming elections, and the impact on economic stability, as they assess investment opportunities. ■



ASIA

The Chinese lodging market is positioned to enter another year of rapid growth. Foreign tourism into China is anticipated to grow by 8% to 9% in each of the coming five years, while Chinese domestic tourism is expected to expand by 5% to 6%. As the tourism market is anticipated to grow at double that of the rest of the world, international air carriers are expanding their service to China. The heightened capacity will help to further increase the Chinese tourism market.

One of the major trends in the lodging market is the expansion of international hotel groups into China. Leading hotel companies plan to more than double their inventory in cities such as Beijing, Guangzhou, and Shanghai. Hotel development activity is anticipated to further accelerate in preparation for the Beijing 2008 Olympic Games.

Another growing trend is the development of China as a business travel destination. Westerners are flocking to China to do business in cities such

as Shanghai, which boasts a GDP increase of almost 10% in 2005 alone. As a result, overall visitation to Shanghai rose an estimated 20 percent the same year. With no slowing of the economy anticipated in the near future, the travel market is expected to continue to flourish in the next several years.

Not far from China, Tokyo’s super-luxury hotel market is bound to heat up in the coming years as international brands are rapidly expanding into Japan’s hotel market. With larger average room sizes and added amenities, new entrants are anticipated to increase the average room rate above \$420 a night. Much of the development surge in the luxury segment occurring in Tokyo can be attributed to the improvement in Japan’s economy and the nearing resolution of the bad debt problem that caused the nation’s decade-long reces-

sion and has freed some of the prime land parcels in central Tokyo as part of settlements.

The economic recovery in Japan is being felt across the region. With the baby boomers around the world set to retire in the next few years, the new, super-luxury hotels should have few problems generating demand. Major domestic hotel operators are scrambling to renovate and upgrade their facilities in order to face the onset of competition from a number of new foreign-backed hotels that are anticipated to open by 2007. Although it remains to be seen how the hotel market will fare during what has been dubbed the “Year 2007 Problem,” the dawn of the international, super-luxury hotels is certain to provide tourists with more choice in Tokyo accommodations. ■





CARIBBEAN

According to the Caribbean Tourism Organization (CTO), tourism demand in major island destinations increased approximately 5.1% in 2005. This growth comes despite a highly active 2005 hurricane season that left several hotels and resorts temporarily out of service or, in some instances, completely closed. Further growth is anticipated in 2006 as the U.S. economy grows, airlift to the Caribbean increases, and new supply in the way of luxury resorts and high-end mixed-use projects develops.

Improved airlift from major markets in the U.S. (which accounted for approximately 43% of the total tourism demand in major island destinations in 2005), as well as intra-island connections, are anticipated to continue into 2006. The entry of low-cost carriers is anticipated to further facilitate access to the islands, while simultaneously decreasing the travel costs for the U.S. market.

The development of luxury developments, especially projects involving residences, marinas, and high-end fractional clubs, is anticipated to continue at a high pace in 2006 and 2007.

Driven by a surge of international capital investment, several branded mixed-use developments have been announced, including renowned operators such as St. Regis, Mandarin Oriental, One and Only, Viceroy, Rosewood, and Fairmont. At present, the CTO estimates that over 55,000 rooms are in various stages of development within the Caribbean. Notable openings include the Ritz-Carlton Grand Cayman in the Cayman Islands (December 2005) and the Westin Roco-ki in the Dominican Republic (anticipated November 2006).

Future tourism growth in the Caribbean, however, may be threatened by a variety of external factors. A cycle of more active hurricane seasons may compress tourist growth, while rising interest rates may create demand pressure for second/vacation homes by U.S. buyers. Still, the region remains a highly desirable destination from a tourism perspective, and the investment community has demonstrated increased levels of interest, which should bode well for Caribbean tourism performance in 2006. ■



AUSTRALIA

The Australian hospitality sector enters 2006 in good shape following solid growth in 2005. International visitor numbers to September 2005 were reported to be up over 7% on the previous year, with a substantial growth in Chinese visitors being one of the contributing factors. Increased flights between China and Australia by a number of carriers are expected to strengthen this trend. The increased visitor numbers also translated into solid RevPAR growth across the country.

The most immediate near-term lift for the sector in 2006 will be the Commonwealth Games to be held in Melbourne in March, which by some estimates is expected to attract up to 40,000 international visitors to the city. The Games are also expected to foster domestic travel – a sector that experienced some decline in 2005.

In terms of supply, there are a minimal number of new hotels currently in the pipeline. The re-opening of the Sydney Hilton in mid-2005 following a major refurbishment has been the only significant addition to hotel room numbers. The hotel sector has, however, been dealing with a rise in serviced apartments, particularly in Sydney and Melbourne, following a decline in the inner-city residential apartment market, which left some developers looking for alternative uses for unsold developments. There is an expectation that the level of competition from this area will gradually decline as residential markets improve and absorb some of this supply and the relative attractiveness of some serviced apartment operations falls away (unless the developers commit to refurbishment programs).

major beach resort areas the – Red Sea and Sinai Peninsula – have been less encouraging; the latter being impacted by terrorist attacks.

Looking forward, the growth of the area is expected to continue to be led by Dubai and



MIDDLE EAST

Overall, the region continues to experience strong performance in the hotel sector from both a demand and supply point of view. This can be attributed to the following:

- Repatriation of funds from Europe and North America to the Middle East
- Increased liquidity as a result of record-high oil prices
- Strong economies and commitment to encourage private investment
- Increased intra-regional travel
- Commitment of governments to diversify their economies and promote tourism
- Development of major tourism-related infrastructure projects
- Emergence and growth of regional airlines, budget, and full-service operations

In the wider Middle East area, growth has been evident in Jordan both in business and leisure tourism. The former is driven by Jordan's proximity to Iraq, offering a relatively safe base.

Political tensions in Lebanon during 2005 slowed down the hotel sector that had shown encouraging signs during 2004. Egypt has demonstrated modest growth, primarily in Cairo, but results in the two



INDIA

The Indian hospitality industry is on a high-growth trajectory. Various positive trends, including higher tourist arrivals, improved domestic business confidence, increasing foreign investment inflows, rising consumerism, easier and cheaper finance for vacations, lower air tariffs due to increased competition, greater air connectivity, and an accelerating pace of business activity with increased business opportunities in sectors such as Information Technology (IT) and IT-enabled services / Business Process Out-sourcing, auto ancillaries, have resulted in rapid growth of the hospitality sector.

With the buoyancy in room demand, ADR, and RevPAR, the room supply is set to increase. The existing hospitality companies are expanding and there is a growing trend among hospitality sector players to acquire a multi-locational, pan-India presence. The industry is also seeing a number of incumbent players.

The expansion will necessitate increasing capital flows into the sector, both debt and equity. With increasing gearing levels and buoyant secondary equity markets, a rise in the number of equity placements, private equity, and public offerings is expected to materialize.

Another significant trend is the increasing interest of branding in the budget segment. Traditionally, most of the budget hotels in India have been inde-

Overall, after some difficult years following the Sydney Olympics in 2000, the solid performance of the sector in 2005 and positive outlook for 2006 has seen the attractiveness of the hotel sector as an asset class continue to improve, particularly relative to other investment-grade real estate that has experienced considerable yield compression over recent years.

With the anticipated demand growth and limited new supply, solid returns are expected from the hotel sector in the near term. ■

supported by Abu Dhabi, Doha, and Muscat. Major projects underway or planned in Saudi Arabia are also expected to lead to growth in the country. ■

pendently owned and not part of a branded chain. However, the share of the branded segment is set to rise with various players entering this segment.

With the optimism in the Indian market, an increasing number of global chains are entering India and the existing brands are expanding their distribution, especially in the premium segment.

As a result, the share of these brands in the premium segment is on an upward trend.

Thus, the hospitality industry in India is going through a significant expansion stage, widening and deepening the market. ■



USA

The U.S. lodging market is set for another year of expansion, thanks to solid fundamentals, increased capital flows into the sector, and the opening of more foreign markets. The continuing high levels of debt and equity capital flowing into the lodging sector is one of the primary reasons for expansion in 2006.

As an asset class of choice as evidenced by the huge flows of capital into the lodging sector and cap rate compression in 2005, the lodging sector expects investor appetite for hotel deals to grow in 2006, especially in major markets where room rates have shown strength and occupancy rates have improved.

One possible outcome of this increased capital interest in the hotel sector is an increase in the development of new hotels. Despite the steady growth in hotel market fundamentals, such as occupancy, average daily room rates (ADR) and revenue per available room (RevPAR), there has been a disconnect between those numbers and development of new hotels. This disconnect is expected to change in 2006 as more developers deploy strategies to get new hotels built. The recent surge of hybrid hospitality products is anticipated to remain strong as private residence clubs, high-end fractionals and condominium hotels continue to enjoy great popularity among developers, investors and consumers.

This good news in the lodging sector can be attributed in part to the increasing globalization of the industry, which has attracted foreign capital back into the U.S. markets. ■

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