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Spanish Hotel Market Review and Assessment – Barcelona

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Barcelona – The Art of Reinventing a City

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WHAT ARE THE LATEST TRENDS IN HOTEL PERFORMANCE FOR THE SURPRISING CITY OF BARCELONA?

Following on from the publication of our review on the Madrid market in January 2006, we present in this article our view of the most recent hotel trends on the commercial market of Barcelona city.

Economic Overview

- According to the Economist Intelligence Unit (EIU), real gross domestic product (GDP) is expected to slow gradually to 2.0% in 2010, from 3.3% in 2005. While domestic demand growth will remain solid, it will be lower than in recent years, and net exports will continue to exert a drag on overall economic growth;
- So far, the government has not addressed economic reforms that may prove politically painful, and will probably not do so in the short term. Some of the measures under consideration are the liberalisation of the utilities markets and the financial services sector. If labour market liberalisation does take place in the short term, there are risks it will be limited because of the likely failure of employers and trade unions to reach a compromise;
- Budgetary policy will remain mildly expansionary, as a result of strong tax revenue that has allowed an expansion of social programmes. The EIU expects small budget surpluses over the forecast period;
- Inflation (national measure) averaged 3.4% in 2005, partly fuelled by oil price increases, and is expected to ease in the early part of the forecast period, as domestic demand cools. The current account will remain deep in deficit during the following years, although this is unlikely to threaten macroeconomic stability.

Barcelona

In terms of its political organisation, Catalonia, the region where Barcelona is located, is entitled to have legislative autonomy and executive competence as well as the authority to carry out its own administration by means of its own representatives chosen from the election lists submitted by the political parties. The Generalitat of Catalonia is the political institution comprising the Parliament, the Government and the President, who is the maximum authority in

Catalonia and who represents the whole Generalitat and also the State in Catalonia.

Barcelona is Spain's second-largest city, with a population of approximately 1.5 million, and is the capital of Catalonia. Located on the Mediterranean coast, 180 km southwest of the French border, Barcelona is the country's principal seaport and is the third-largest port in the Mediterranean region.

Barcelona is a major manufacturing centre, accounting for about one-fifth of Spain's industrial production. The city is also an important banking and financial centre, and its transport links and its proximity to France have helped to attract considerable foreign investment.

Barcelona has a wealth of cultural attractions, including a well-preserved medieval centre, and has a reputation for being a centre of modern and avant-garde art. These attractions have made Barcelona one of the country's principal tourist destinations, particularly since its international exposure in 1992 when it hosted the Olympic Games. In 1999, the city was awarded the Royal Institute of British Architects' gold medal, the first time the prize has been won by a city rather than by an individual.

The success of Barcelona's tourism industry over the past decade is, of course, due to the Olympic Games, although this success would not have been possible without the enormous investment made by the local authorities – investments such as the new port and the surrounding infrastructure and facilities, which were built largely for the Olympic Games. In less than ten years, Barcelona has become a favourite short-break leisure destination in line with cities such as Paris, London and Amsterdam. In addition, Barcelona is a growing centre for meeting, incentive, conference and exhibition (MICE) business and is an increasingly important port for cruise ships. Before the Games, Barcelona was hardly considered in terms of its being a coastal city and had no real beachfront. Today the city boasts several kilometres of beaches and a cruise terminal that is fast becoming as important as those in the leading Mediterranean ports.

Barcelona has been successful in creatively reinventing itself through a whole new approach to urban design: inventing fresh uses for the old districts, blending old architecture with new, and creating aesthetically pleasing public spaces (small parks, walkways and museums) to attract private development to previously dubious areas. The local authorities have successfully marketed these projects by staging high-profile international events.

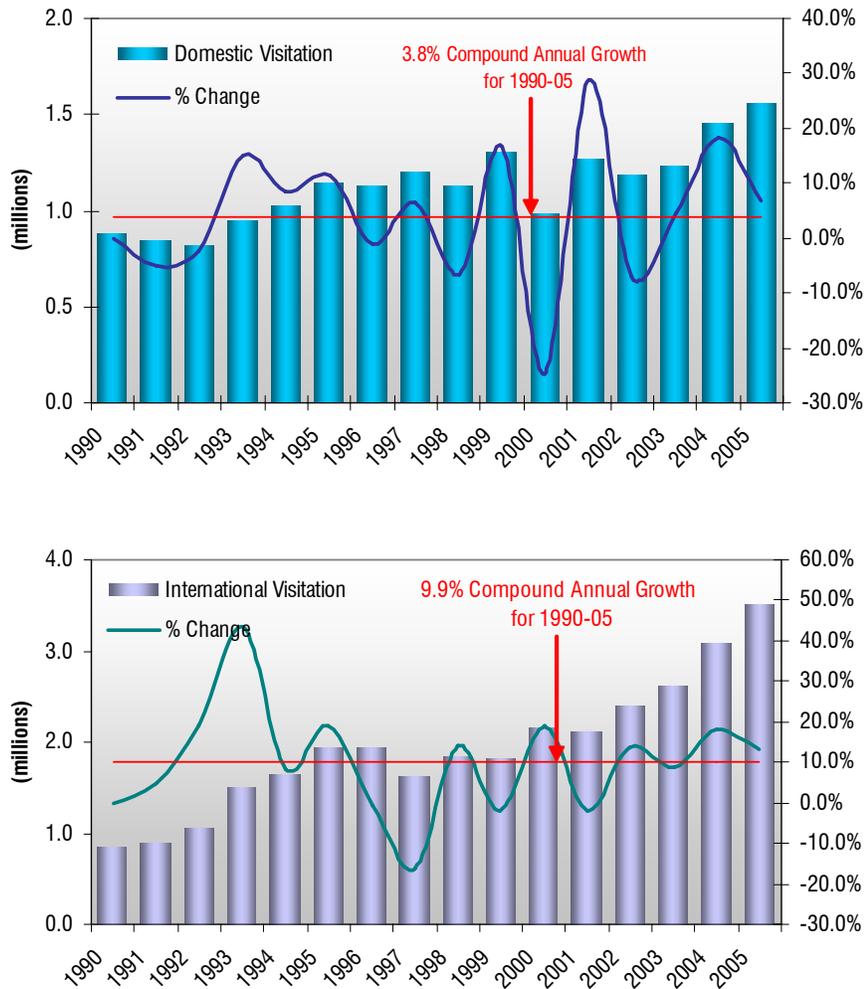
Tourist Arrivals and Demand

- As illustrated in Figure 1, visitation to Barcelona from 1990 to 2005 increased by an impressive 192%, which represents a healthy 7.4%

compound annual growth. The growth in the number of tourism visits over this period has been especially impressive for international visitation, which experienced a compound annual growth of almost 10% since 1990;

- The increase in total visitation to the city in 1993, after the 1992 Olympic Games, was 31%. That year, international visitation increased by over 43%;
- Despite unfavourable economic global conditions, the effect of the terrorist attacks in the USA and the global economic slowdown over the last few years, overall visitation to Barcelona has not experienced a single decrease since 1997, as declines in either international or domestic visitation have always been offset by increases in the other;
- Meanwhile, the proportion of domestic to international tourists has shifted from a majority of local visitation of 51% in 1990 to slightly over 30%, reflecting the notable increase in visitation from abroad;
- In 2004, the total increase in visitation to Barcelona was 18.2%, the healthiest since 1993. The increase was lower in 2005, at 11.2%, but still remarkably high.

Figure 1 Domestic and International Tourist Arrivals – Barcelona (Millions)



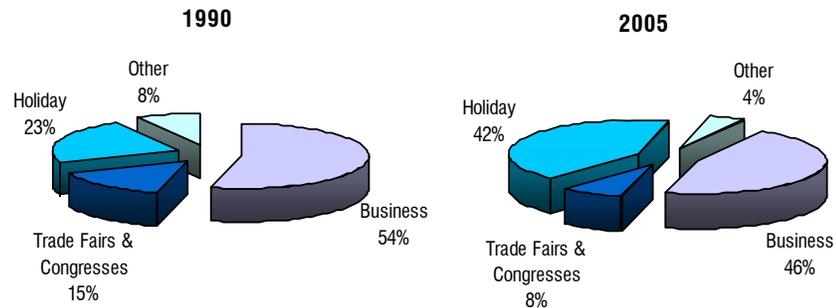
Source: Turisme de Barcelona

In 2005 the main international feeder market to the city of Barcelona in terms of visitation was the UK, which accounted for almost 13% of total visitors. It was followed by Italy and the USA, both with approximately 8% of the total share, France with over 6% and Germany with 5%.

As can be seen from Figure 2, from 1990 to 2005 holiday travel increased substantially, showing a compound annual growth of almost 12% over these years. The share of visitors coming to Barcelona on holiday increased from 23% in 1990 to 42% in 2005. Business travel and travel relating to trade fairs and congresses in Barcelona have also grown, but at lower rates compared with the holiday segment, and have thus

decreased their market share. As a result, it appears that Barcelona is becoming more of a leisure-oriented destination.

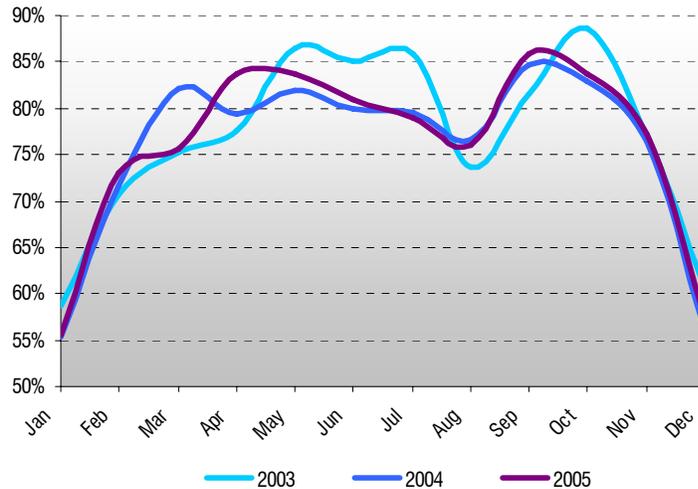
Figure 2 Total Visitation by Purpose of Visit – 1990 versus 2005



HOTEL MARKET PERFORMANCE AND CHARACTERISTICS

Over the last few years, Barcelona has successfully managed to change its profile to attract leisure tourism, and it is our view that the city is positioning itself as a holiday and short break destination. Leisure demand has grown noticeably in recent years, and, given the international exposure that the city gains through its marketing and promotions, leisure demand is expected to continue to grow. Conference and incentive demand has also expanded in recent years and is expected to grow further. Barcelona holds approximately 80 trade fairs every year, and according to the Statistics Report of the International Congress & Convention Association (ICCA), it was the most popular city in terms of meetings held in 2004, out of a total of 100 cities. In July 2005, the Generalitat approved the completion of the Gran Via Exhibition centre, which will be the second largest in Europe. It is expected to be concluded in 2009. Since 2004, 15 new trade fairs have been created and captured and 2006 expects to see some 14 new events held in Barcelona, according to the Fira de Barcelona.

Figure 3 highlights the seasonality in occupancy in 2003, 2004 and 2005.

Figure 3 Occupancy Seasonality Barcelona 2003-05

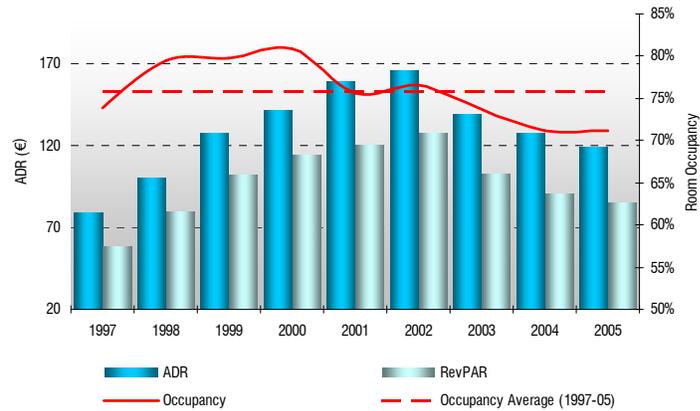
Source: Turisme de Barcelona

The three curves indicate a healthy balance of demand, with arrivals spread fairly evenly throughout the year. Occupancy reaches levels below 70% only during the months of January and December; hence, there is the potential for higher marketwide hotel occupancy, albeit limited.

Occupancy and Rate Performance

- The aggregated performance of quality hotels in the city of Barcelona achieved an average of approximately 72% in the 15 years from 1991 until 2005. An impressive peak of around 84% in 2000 was followed by a progressive, albeit smooth decrease over the last few years. Occupancy levels since 2003 have been in the region of 76-77%, despite the high increases of supply over this period, which reflects the exceptional resilience of this market;
- The average daily rate (ADR), on the other hand, kept increasing until 2002, when it reached levels of around €166 (€179 in 2005 prices), and has suffered a continuous decrease since. The aggregate ADR of €119 achieved in 2005 equals the ADR achieved in 1998 (if inflated to 2005 prices). Although we would expect the market to experience a rebound in ADR in the future, recent increases in supply are still putting downward pressure on rates, as new hotels fight to get market share;
- In terms of the revenue per available room (RevPAR), the peak was also attained by the Barcelona market in 2002, thanks to both the high occupancy and the highest ADR. It decreased to €85 in 2005, its lowest level since 1997 in constant prices.

Figure 4 Hotel Performance in Barcelona 1997-05

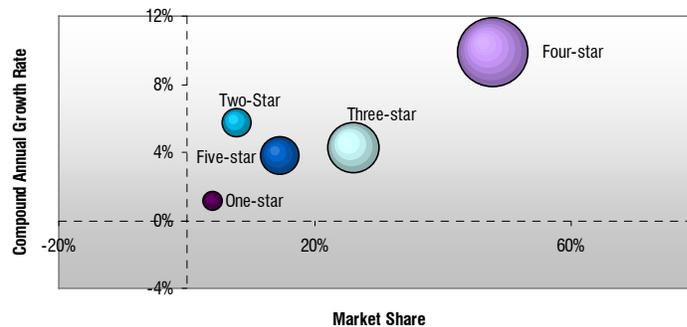


Source: Deloitte & Touche

New Supply

There has been an impressive growth of the four-star category in Barcelona since 1991. This category of hotel experienced a compound annual growth rate (CAGR) of 10% up until 2005, compared with an overall growth for all types of hotels of 6%. It is nevertheless the five-star hotels that showed a remarkable growth of almost 20% since 2000, increasing the number of rooms at the upper end by 143% (the actual number of five-star hotels increased from six in 2000 to 13 in 2005). The CAGR for all hotels since 2000 is 10%, with one-, two- and three-star hotels showing lower growths of 2.8%, 7.6% and 8.6%, respectively.

Figure 5 Market Share and Compound Annual Growth Rate by Category of Hotel – Barcelona



Source: Turisme de Barcelona

According to the official statistics of the city of Barcelona, as at December 2005 it was expected that some additional 41 new hotels would enter the market over the following three years. This is slightly over 5,800 rooms, which would represent an increase of 23% of the existing supply. Some

of these projects, nevertheless, are still at a speculative stage and may not materialise.

Figure 6 Estimated New Supply – Barcelona

Estimated Opening	Star Category	Number of Hotels	Number of Rooms
2006	Five-Star	4	531
	Four-Star	14	1,528
	Three-Star	2	83
	Two-Star	—	—
	One-Star	—	—
	Subtotal	20	2,142
2007	Five-Star	2	400
	Four-Star	9	1,436
	Three-Star	2	235
	Two-Star	—	—
	One-Star	—	—
	Not Yet Determined	3	226
	Subtotal	16	2,297
2008	Five-Star	2	754
	Four-Star	2	492
	Three-Star	1	138
	Two-Star	—	—
	One-Star	—	—
	Subtotal	5	1,384
Total New Projects		41	5,823

Source: Turisme de Barcelona, HVS International

Although the strongest increases in supply since 1992 were experienced over 2003, 2004 and 2005, with increases of 8%, 14% and 7% of the total supply, we would expect that the additional 5,800 rooms, should they materialise, are likely to continue to have a short- to medium-term impact on marketwide operating performance. Having said this, Barcelona has proven to be a highly resilient market, and we would expect it to successfully absorb the new demand.

The following international brands are expected to open properties in the next two years in Barcelona.

Figure 7 Internationally Branded Hotel Projects

Chain	Number of Rooms	Brand	Name of the Hotel	Estimated Opening
Marriott Hotels & Resorts	259	Renaissance	Renaissance Barcelona Airport	2006
Mandarin Oriental	144	Mandarin Oriental	—	2007
Starwood Hotels & Resorts	475	W Hotels	W Barcelona	2008

Source: Turisme de Barcelona, HVS International

Hotel Valuation Index

According to HVS International's European Hotel Valuation Index 2006, hotel values (expressed in euro) have achieved a second consecutive year of growth across Europe. Barcelona, nevertheless, has been the only market out of the 28 reviewed which has shown a decrease both in 2004 and in 2005. The 5.4% decline in values in 2005 was mainly due to the decrease in ADR and relatively unchanged occupancy levels, and to the significant increases in demand. But as the number of new projects under construction is slowly starting to decline, we would expect hotel values to recover over the short to medium term.

Figure 8 shows some of the most important transactions in Barcelona over the last few years.

Figure 8 Main Hotel Transactions in Barcelona 2001-04

Property	Category	Sale Date	Number of Rooms	Estimated Price	Price Per Room
Arts Hotel Complex	5-star GL	July 2004	482	320,000,000	664,000
Le Meridien Barcelona	5-star	January 2003	212	85,000,000	401,000
Princesa Sofia	5-star	January 2003	500	135,500,000	271,000
Arts Hotel Complex	5-star GL	October 2001	482	234,000,000	485,000

Source: HVS International

CONCLUSIONS AND OUTLOOK

General Outlook

- Spain's economy remains very dependent on the construction sector, and on the government's ability to further decrease unemployment. However, Spain has been growing at levels above the EU average, and the current and intermediate outlook for the economy is very positive;
- Barcelona has followed the pattern of other Olympic cities, enjoying a strong increase in convention demand and rapid development of its leisure market, which have boosted the local economy and investment. Barcelona is one of Europe's most innovative and dynamic cities, and its success in creatively renewing itself has become an example for city planners around the world;

- The whole country has demonstrated its resilience to terrorist attacks of different magnitudes, as these events have not triggered a significant decrease in visitation and had only a minor impact on the country's tourism industry. Additionally, the recent ceasefire from the terrorist band ETA ensures an even more secure surrounding for tourism.

Hotel Market

- Barcelona has undisputedly managed to position itself as the best known Spanish city for short leisure visitation. The ongoing development of its fair grounds also has a positive impact on the MICE segment, which broadens the seasonality of hotel demand;
- The strong increases in visitation to Barcelona have allowed for this market to enjoy an exceptionally resilient occupancy, despite strong increases in supply in recent years. Average prices have nevertheless suffered in the process, and we expect no significant improvement in the short term as more rooms continue to enter the market;
- Overall, we consider that Barcelona will maintain strong occupancies over the next few years. However, a recovery of the ADR is likely to take a few years, given the new supply which is expected to enter the market and put downward pressure on prices in the short to medium term.

Hotel Investment Opportunities

- Over the last few years, Spain has been one of the most resilient markets in Continental Europe, mainly due to international travellers and as a result of sizeable new hotel supply in recent years. Both Barcelona and Madrid continue to be considered as key investment markets with a strong interest from international investors;
- According to available market data, significant investment activity has occurred since 1999, and it is predicted to continue over the next few years, with Spain becoming one of the most liquid countries in Continental Europe;
- As a consequence of the difficulty in penetrating this market, and the Spanish market in general, international operators have had to become more creative in recent years, and have decided to join those they can't beat, accepting joint venture agreements with local companies, improved franchise agreements and lease contracts – typically structured with a fixed and variable component. However, enthusiasm for hotels with management contracts is stronger than it was a few years ago, mainly in the budget hotel category, as management companies are doing better on the whole and investors have a better understanding of the industry;

- Barcelona has experienced very robust increases in demand for over a decade, and this has counterbalanced the strong increases in supply over the last few years. Having said this, some hotels might need to be reconverted to other uses or may go on sale over the next few years, which will make the market more appealing for potential investors;
- Although the Barcelona market has some presence from international operators (Hilton, Le Meridien, Ritz-Carlton), it is mainly dominated by domestic operators and independent hotels. We consider that there is potential for interesting transactions to take place between international operators (backed by foreign investors) and Spanish owners/operators recently invested in the hotel sector, and willing to realise capital gains on their hotel investment.

Note: *No investment decision in this market should be based on this article. For further information or advice, please contact the authors.*

About the Authors



Sophie Perret is a Senior Associate with HVS International's Madrid Office. She joined HVS International in 2003 and has ten years' operational experience in the hospitality industry in South America and Europe. Originally from Buenos Aires, Argentina, Sophie speaks English, Spanish and French. She holds a Bachelor degree in Hotel Management from Ateneo de Estudios Terciarios, and an MBA from IMHI (Essec Business School, France and Cornell University, USA). Since joining HVS International, she has advised on a number of hotel investment projects and related assignments in Spain, Portugal and other European countries.



Philippe Bijaoui is the Managing Director of HVS International's Madrid Office. He joined HVS International in 2005, after being in charge of the development of the Radisson SAS, Regent and Park Inn brands in Southern Europe and Benelux with Rezidor SAS Hospitality for the previous four years. He had been previously eight years working on hotel and mixed-use real estate developments for hotel investment companies. He was Director of Acquisitions for City Hotels (listed on the Brussels stock exchange) and he was Managing Director of Credicom Exploitation, the asset management subsidiary of Groupe SIH. He holds a Bachelor of Arts degree in Sociology and Anthropology from Tel Aviv University, and a Master of Business Administration from IMHI, a joint programme of Cornell School of Hotel Administration and ESSEC Business School.

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