2020

Moscow hotel market overview

March 2020

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CUSHMAN & WAKEFIELD

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After the “2018 World Cup year”, 2019 saw a continued inflow of visitors (both Russian and foreign) to Moscow, which not only reached the 25.1 million visitors’ mark (a 6.4% increase compared to 2018) but also visibly changed the demand structure of the market. While the share of business trips still remains dominant and exceeds 42–45% of all accommodated demand, starting from 2016, the city has seen a growing share of leisure-related visits, with up to 40% of accommodated guests arriving for cultural, tourist, personal, and other purposes. Hotel demand in Moscow and perhaps even the well-being of the tourism industry in Moscow in 2020 will likely be affected by the further development of COVID-19. At the time of this study, there were already signs of a slowdown in the tourism industry (restrictions on in-bound travel, quarantine measures, reservation cancellations, postponement or cancellation of events). The real effect of such temporary measures will be visible only by mid-spring when the mass tourism season usually starts.

Supply

As of late 2019, Moscow’s modern-quality hotel stock, in Cushman & Wakefield’s expert opinion, amounted to 20,200 rooms, representing just over one-third of the combined room stock in the capital. After the market stock increased by nearly 2,500 rooms in 2017–2018 (annual growth rates of 9.4% and 4.0%, respectively) and minimal growth in 2019 (128 rooms in one new hotel opening), the average annual growth rate in 2020–2025 will likely not exceed 4.0%. Net expected market growth in 2020 is 832 rooms (4.1%).

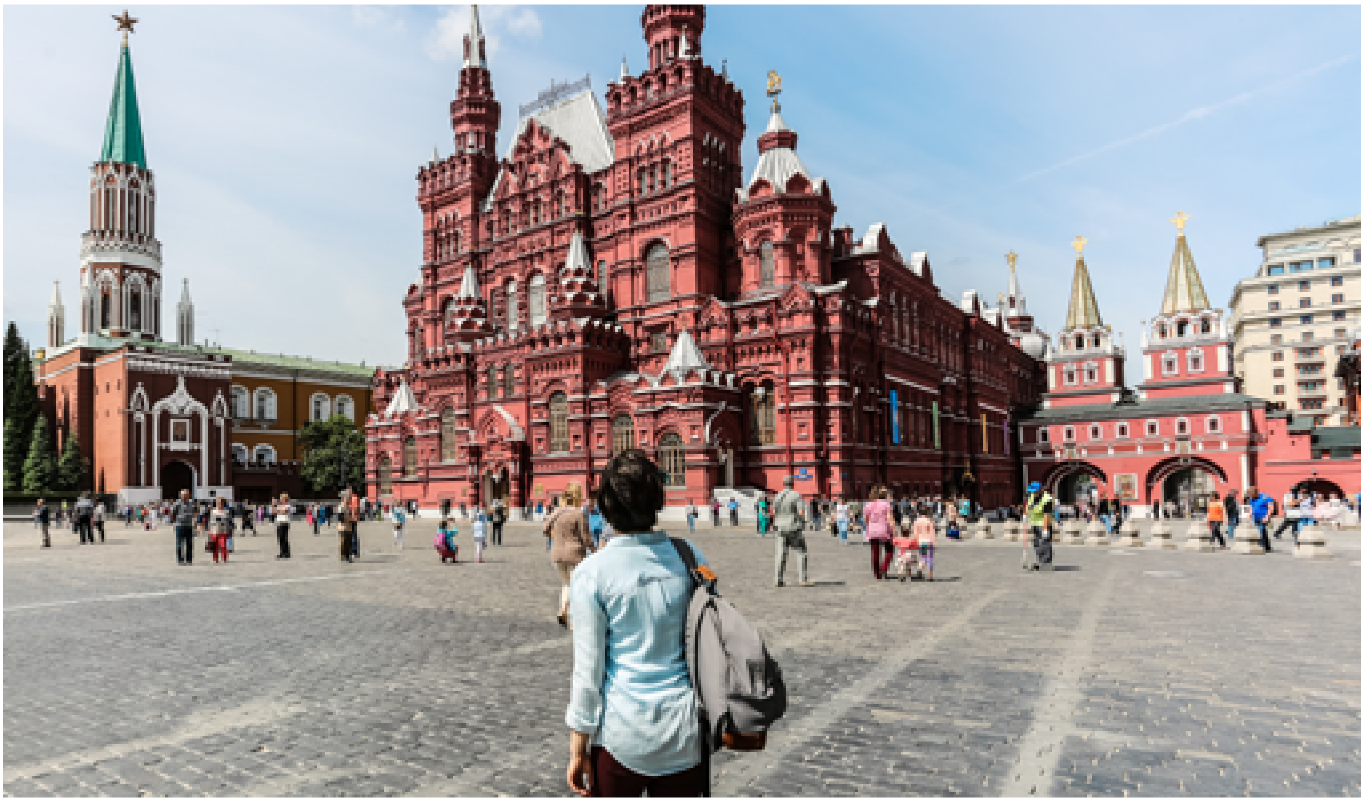
Operating results

Following the 2018 FIFA World Cup, it took the Moscow market at least six months to find a new balance between supply and demand. As a result, Moscow hoteliers spent the first quarter of 2019 in a state of anxiety. The arrival of spring, however, brought with it the first signs of improved confidence levels manifested in consistent monthly outperformance of occupancy levels compared to previous years. By the summer, it became clear that the increased demand for hotel accommodation was ready to set new records, giving Moscow hoteliers means to increase open rates. As a result, the 2019 full-year occupancy rate in the modern-quality hotel segment reached 78.0%, even though average daily rate (ADR) growth remained largely subdued (a 2.9% increase vs. 2017 results — from RUB 6,567 to RUB 6,759). 2020's buoyant start made hoteliers confident that they would be finally able to start focusing on yield management rather than on trying to sell as many rooms as possible. However, the rosy picture of the world as of late January 2020 and the "reasonably optimistic" projections rolled out by hotel managers suddenly came to a halt due to the coronavirus, which is likely to have a direct impact on the operating performance of the city's hotels, at least in the first half of the year. The full effect that the COVID-19 infection may have on the hotel market can only be gauged by mid-spring.

Investment market

Investors' interest in prime hotel properties in Moscow and St. Petersburg remains high, and a shortage of such assets coupled with real existing barriers to entry in these markets contribute to initial yield compression. At the same time, with a few exceptions (e.g., the Tsentralnaya Hotel deal reported in early 2019 and earmarked by new foreign owners for complete redevelopment), the Russian hotel investment market remains local.

Demand



Arrivals and top feeder markets

2019 saw continued growth in visitors to Moscow, a logical result of persistent efforts of the local authorities to make the city more attractive to tourists, both domestic and international. The successful completion of the urban revival programme in Central Moscow, an impressive calendar of public events (street festivals and other themed events) annually hosted in the capital, and wide availability of accommodation facilities to every taste and budget all contributed to Moscow being named the 2019 World's Leading City Destination. Additional positive factors increasing the number of visitors were the "championship effect" when fans and participants of the 2018 FIFA World Cup "discovered" Russia and Moscow and — last but not least — a growing list of countries whose citizens can visit Russia without a visa (for example, the United Arab Emirates).

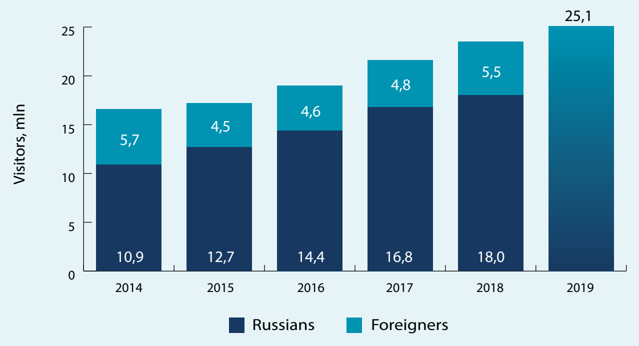
The aggregate effect of the measures and factors listed above allowed Moscow to report 25.1 million visitors in 2019, exceeding the 2016 results (16.6 million) by a factor of 1.5. What's more important is the positive growth trend, as shown in Diagram 1.

At the time of this study, official data on the split between Russian and foreign visitors in 2019 were unavailable, but even a quick glance at the 2014-2018 statistics is enough to see a growing trend in the share of domestic demand regardless of the increased number of foreigners in 2018 due to the 2018 FIFA World Cup. If in 2014 the share of Russian citizens visiting Moscow for various purposes represented 66% of all arrivals, by 2018 their share reached 77% of all visitors.

The sharp increase in the number of guests accommodated by Moscow hotels (from 5.6 million in 2015 to 8.5 million in 2016 and 9.8 million in 2017) shown in Diagram 2, in Cushman & Wakefield's opinion, is reflective not so much of a sudden surge in hotel demand but of a change in the number of lodging facilities tracked by the Federal Statistical Bureau which, starting from 2016, surveys a wider range of hotels. One hopes that such an expansion will ultimately paint a more objective picture of the Moscow lodging landscape. Another big increase in the number of accommodated persons recorded in 2018 (year-on-year growth of 69.1%) is due mainly to the "championship effect" when, according to the City of Moscow, during the weeks of the football mega-event the capital hosted more than 4.5 million visitors, of which 2.3 million were foreign tourists and 2.2 million were domestic visitors.

When analysing the hotel accommodation demand, one can see a gradual increase in the share of foreign guests, from 33–34% in 2012–2014 to 37–38% in 2017–2018, which indicates a growing interest on the part of foreigners in visiting the Russian capital (thus, the dominant — and growing — share of domestic demand in the total Moscow arrivals noted above to a large extent consists of day visitors who do not generate hotel stays). While no full-year statistics for 2019 were available at the time of this study, the preliminary (monthly) data on foreign citizens lodged by the Moscow collective means of accommodation (the definition of this term is provided in Section "Structure of modern quality stock") published by the Federal Statistical Bureau put their share at 39.6% of total accommodated persons, which is in line with the trend described above.

Diagram 1. Moscow arrivals, actuals for 2014-2018, forecast for 2019



Source: Tourism Committee, City of Moscow, 2020

Table 1. Moscow arrivals, 2014–2019

Year	2014	2015	2016	2017	2018	2019
Arrivals, mln %	**16,6**	**17,2** 3,6	**19,0** 10,5	**21,6** 13,7	**23,5** 8,8	**25,1** 6,4
Russians %	**10,9**	**12,7** 16,5	**14,4** 13,4	**16,8** 16,7	**18,0** 7,1	no data
Foreigners %	**5,7**	**4,5** -21,1	**4,6** 2,2	**4,8** 4,3	**5,5** 14,6	no data

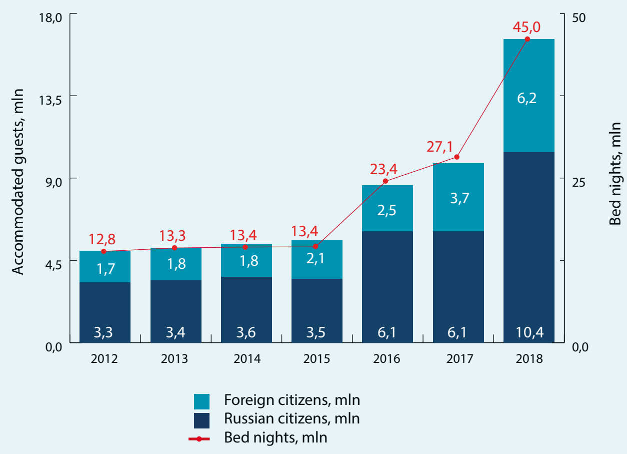
Source: Tourism Committee, City of Moscow, 2020

Demand

Overall, however, the dynamics of accommodated hotel guests in 2017–2018 were in line with growth in the number of overnight stays (69.1% and 66.1%, respectively), which meant that the average stay remains practically unchanged at 2.7–2.8 nights.

The list of the main feeder markets (Diagram 3) also remains stable, although the share of some countries saw a sharp reduction following the launch of 2014–2015 sanctions. For example, the number of UK citizens visiting Moscow in 2018 was 24.6% lower than in 2013, and the number of Turkish citizens was 47.3% lower. Against this backdrop, the real champions of growth are countries enjoying the visa-free program – first and foremost, China (113.4% increase in the number of tourists between 2018 and 2013) as well as South Korea (74.8%), and Israel (49.3%).

Diagram 2. Moscow hotel demand



Source: Moscow Statistical Bureau, 2020

Demand structure

2019 revealed a structural change in the Moscow hotel market. It still holds true that Moscow remains, first and foremost, the political and economic centre of the Russian Federation and its hotels generate sizeable volumes of business-driven demand, which creates clear weekly and yearly seasonality patterns. At the same time, starting from 2016, as Diagram 4 demonstrates, the city has seen a growing share of leisure-related demand (arrivals with cultural, tourist, personal, and other purposes). Visitors are attracted by a whole range of city festivals and other urban events, including the most popular one, Moscow Seasons. These four large-scale seasonal outdoor events (Journey to Christmas, Moscow Spring A Cappella, Flower Jam, and Golden Autumn), which host 65-66 million Muscovites and other visitors per year, have turned Moscow into one of the most popular and attractive tourist cities in the world. This status was recognized by industry professionals when World Travel Awards named Moscow the 2019 World's Leading City Destination. Aside from this "tourist-industry Oscar", in recent years the city has regularly featured on short lists of the most comfortable and developed global cities. For example, in 2019 the city was named one of the Top 5 Best Cities (along with London, New York, Paris, and Tokyo).

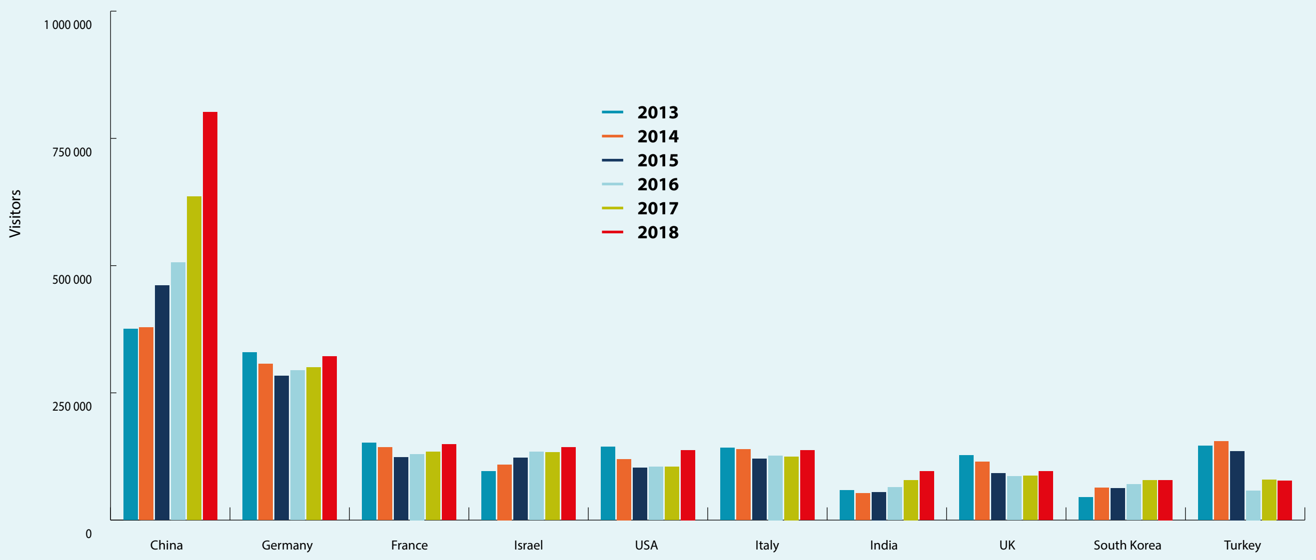
A growing share of leisure-related trips in the overall arrivals to Moscow has clearly increased hotel occupancies. An example of such "new normal" is the now-typical practice for city hotels to report record-high (95–100%) levels of occupancies during seasonal holidays (New Year/Christmas, May holidays) which, until recently, were the periods of lowest demand. Having said that, both individual and group leisure travellers, as a rule, have higher accommodation rate sensitivity (vs. business travellers). This in part explains the low growth rate of Moscow hotel rates (see Section "Modern quality hotels — operating results").

Nevertheless, a noticeable increase in the number of non-business-related trips (including shopping and leisure) potentially allows hotels to grow the overall share of rooms sold at "open rates" (include best available rates and rates offered through websites such as booking.com), which change dynamically in response to any fluctuations in demand. To reduce the level of booking fees payable to online sales channels, branded hotels actively try to maximize the volume of room nights sold through their direct channels. Thus, if used with skill, open rates can be a tool for hotels to drive up their average daily rate (ADR).

Transient business demand (both for individual travellers and corporate accounts) remains flat, reflective of a lack of significant improvements (actual and expected) in the Russian economy and political life. This effectively strengthens the negotiation positions of large corporate users, thereby creating an opportunity for price wars between hotels (including those of different formats/categories) and preventing corporate rates from increasing. All market players surveyed for this study noted a minimal change in corporate rates both in 2019 and 2020.

The booking window in the transient segment remains short and rarely exceeds one week. Such a short booking window is caused by several factors, including increased market supply (see Section "Prospects of further supply

Diagram 3. Top 10 feeder markets



Source: Tourism Committee, Moscow Tourism & Hospitality Development agency, 2020

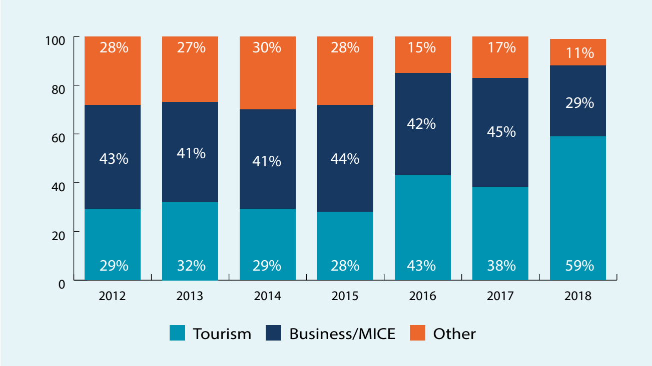
Demand

growth"), which allows a prospective traveller to find an available hotel room practically any day of the year (although some may blame this last-minute booking tradition on "Russian mentality"). Another reason is the reduced share of foreigners among business travellers (meaning fewer foreigners need to obtain a Russian visa that might require hotel booking confirmation) as a direct consequence of the "import-replacement strategy", whereby many foreign companies opened/ moved manufacturing facilities to Russia.

In the MICE segment, the number of large annual trade fairs featuring at least 1,000 exhibitors/delegates (4–5 events per year) as well as "one-offs" (1–2 events per year) remains unchanged, and they still generate enough accommodation demand, enabling hotels to increase their profits during the business season. With respect to smaller business-related and private events usually held in hotels, their budgets still do not show signs of growth, but their volumes do. To mitigate the still-stagnant situation with flat conference and meeting package rates, city hotels continue to diversify their menus, coming out with more economic options suitable to budget-conscious companies and betting on the "lower package/higher volume of repeat business" strategy.

The 2017–2018 increase in guest room supply (see Section "Modern quality supply") and intensifying competition from independent venues (various banquet halls, restaurants, pavilions, and other similar establishments) — all of this not helped by the lack of active growth on the part of the national economy — reduced the booking window for staple business events (groups of 50–200 delegates) to 1 week. 3–4 years ago, organizers tried to reserve a meeting venue and arrange accommodation at least 1–1.5 months ahead of such events. One also has to keep in mind that in the MICE segment, Moscow hotels with conference venues compete not just within the same market but also with other suitable properties in St. Petersburg, Sochi, Moscow Region, Kazan, and other regional markets.

Diagram 4. Hotel demand structure, 2012-2018



Source: Moscow Statistical Bureau, 2020

Accommodation demand from organized leisure groups showed a good growth rate in 2019, providing stable occupancies in hotels traditionally working with these clients from late April to late September. Global tour operators continue to bundle Moscow with St. Petersburg, so any unexpected change in the "rules of the game" in St. Petersburg (including, but not limited to: changing dates for the St. Petersburg Investment Economic Forum [SPIEF], significant increase in hotel rates demanded by St. Petersburg hotels, etc.) has a direct impact on the summer season for the Moscow hotel market. Market players interviewed for this study expressed certain concerns over the ultimate success of the 2020 summer season due to the fact that St. Petersburg was selected to host a number of high-profile international events, both sporting (EURO 2020) and political (Shanghai Security Council, BRICS Summit) in nature. All this activity was likely to cause an accommodation deficit and outprice global tour agencies, thus making them omit Moscow along with St. Petersburg from their "sights-to-see" lists. However, the unexpected development of COVID-19 (see Section "Demand in 2020 and beyond"), which forced Russia to cancel the 2020 SPIEF and put restrictions on international travel from certain countries affected by the spreading disease, created a whole different type of risk for the 2020 tourism season.

Demand in 2020 and beyond

Hotel demand in Moscow and perhaps even the well-being of the Moscow tourism industry in 2020 will likely be affected by the further development of COVID-19, a viral infection which began spinning out of control in late January 2020 in certain areas of China before spreading to a number of countries across the globe. At the time of this study (early March 2020), there were more than 130,000 affected, more than 5,000 deceased, and nearly 70,000 recovered patients across the world. Strict quarantine measures adopted by the Chinese government and in a number of other countries, including the Russian Federation, have slowed further spread of the infection. However, it will take a few more months before one can measure the real effect that COVID-19 may have on global tourism and the global economy.

With respect to the Moscow hotel market, the coronavirus epidemic is likely to affect, first and foremost, the leisure group business (mostly, in-bound tourism) and the MICE segments (both routine business meetings as well as large congress and exhibition events of national and international levels). At the time of this study, there were already signs of a slowdown in these business segments (restrictions on in-bound travel, quarantine measures, reservation cancellations, postponement or cancellation of events). The real effect of such temporary measures will be visible only by mid-spring when the mass tourism season usually starts. In this respect, one can only hope that such force-majeure events like the coronavirus will prove to be rather short-lived, as seen previously with other unexpected epidemics and infectious diseases spreading out of control — such as SARS (or "atypical pneumonia") in 2002–2004, H1N1 (or "swine flu") in 2009, Ebola in 2014, Zika in 2015, and others — each of them creating mass fear and causing a temporary halt in international travel. Moreover, if the previous pandemics can be used as a benchmark, once the active phase of the spread of the disease has passed, international travel (including postponed business) rebounds fairly quickly, as Cushman & Wakefield's in-house research shows. With this in mind, the second half of 2020 may be more positive for Moscow hotels than the first half of the year.

Looking beyond 2020, one cannot but note the clear, growing pattern in annual volumes of Moscow arrivals, and this trend will be helped by the scheduled (January 1, 2021) launch of the visa-free program for single-entry trips (both business and leisure) in all regions of the country. Current visa-free zones in the Far East, Kaliningrad, and Leningrad regions as well as St. Petersburg are clearly used as pilot cases to iron out any administrative barriers and deficiencies. So, Cushman & Wakefield's mid- to long-term forecast of continued growth in demand for hotel accommodation in Moscow — thanks to increasing visitation — remains positive.

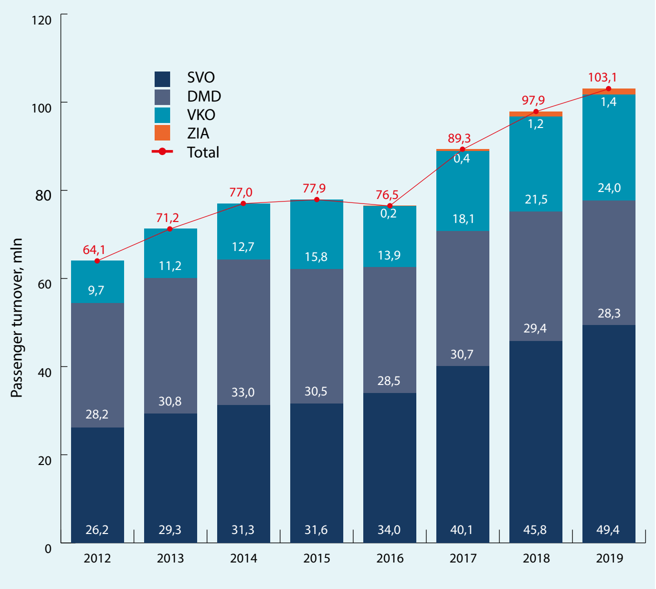
Moscow airports

Moscow is served by four civilian airports (Sheremetyevo, Domodedovo, Vnukovo, and Zhukovsky) with a combined transport capacity of 150 million passengers a year. Moscow is the main hub of all domestic and international air transportation in the country. In 2019, according to Rosaviatsia (the federal agency regulating aviation transport), passenger turnover in Moscow airports reached 103.1 million, or 47% of all commercial passenger flights to/from Russia.

For several years in a row, Sheremetyevo has occupied the number one spot, being the main hub for the largest national air carrier, Aeroflot-Russian Airlines. Over this period, Sheremetyevo grew its share of total passenger turnover from 41% in 2012–2015 to 48% in 2019. Over the same period, the share of the second-largest airport, Domodedovo, which traditionally works with large-scale charter companies, decreased from 44% in 2012 to 27% in 2019. The number of passengers flying to/from Vnukovo continues to increase, but even the 23% share in passenger turnover held by the third largest airport (2019 data) makes it hard to compete with the two main gateways to Moscow. Finally, Zhukovsky, opened in May 2016 and still the only airport without a direct Aeroexpress train to the center of Moscow, is showing rapid growth in passengers (from 425,000 in 2017 to 1.4 million in 2019), but its impact on the overall passenger dynamics of the Moscow aviation complex is still minimal.

To continue increasing passenger turnover capacities, both Sheremetyevo and Domodedovo keep upgrading airport infrastructure. Over the last 3–4 years, both airports significantly improved the level of passenger comfort by opening new passenger terminals: Terminal B serving up to 20 million passengers per year opened in Sheremetyevo in early 2018, while in 2016 Domodedovo finished complete renovation of Terminal T1 and in 2018 partially opened Terminal T2. The newest opened passenger terminal, Terminal C at Sheremetyevo, officially opened in January 2020 and is large enough to process 20 million passengers per year. In September 2019, Sheremetyevo also launched its third runway – another stepping stone in the airport's strategic goal of entering the world's top 10 largest airports, serving 100 million passengers per year. Domodedovo, the runner-up, is still trying to complete its third runway (scheduled to open in 2020), which remains the main prerequisite for the full launch of Terminal T2 to able to serve up to 45 million per year.

Diagram 5. Moscow Aviation Complex – passenger turnover dynamics



Source: Rosaviatsia, websites of Moscow airports, 2020

Modern quality supply

Structure of modern quality stock

As of late 2019, the city officially counted 1,378 collective means of accommodation[1] (CMA) with a combined capacity of 71,000 rooms and 216,000 beds. Of these, the room stock offered in 816 hotels of various grades (and having official certificates) comprised 54,000 rooms and 112,000 beds, and the balance was split between hostels and furnished apartments.

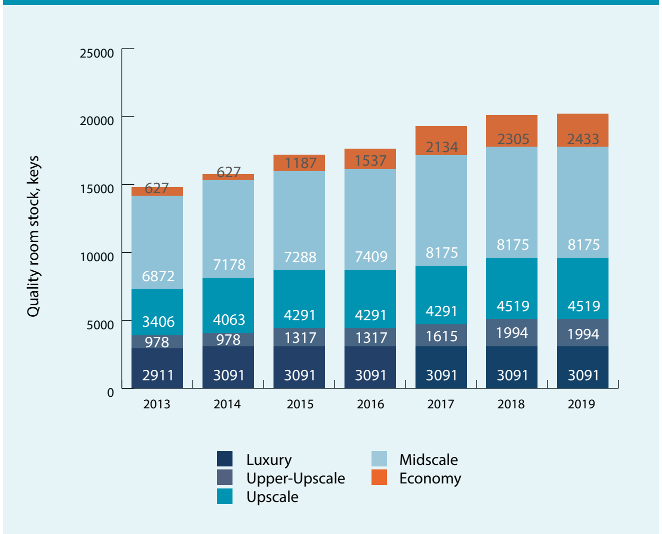
However, due to the wide diversity of the officially registered lodging establishments, Cushman & Wakefield maintains its own database focused on "modern-quality hotel stock"[2]. As of late 2019, Moscow modern-quality hotel stock, in Cushman & Wakefield's opinion, amounted to 20,200 rooms, which still represents just over one-third of the combined room stock in the collective means of accommodation in the capital.

Prospects of further supply growth

Between 2010-2019, Moscow modern-quality stock grew by 168%[3], increasing at an average rate of 7.5% per annum, with peaks in 2010 (21.1%), 2011 (10.1%), and 2017 (9.4%). Obviously, the largest increases in supply take place as the economy bottoms out after a crisis, when it becomes possible for investors to complete development projects that had been experiencing delays due to reduced demand and/or project financing deficits.

In Cushman & Wakefield's view, it is the lack of positive news about growth prospects for the national economy over the foreseeable future, among other factors, which is to blame for the meagre expected supply growth rates in 2020-2025, during which the average annual increase is expected to hover around 4.0%. Besides macroeconomic factors slowing down the arrival of new hotel projects, no less important barriers are the deficit of suitable land parcels (considering the fundamental importance of the locational factor for the ultimate success of a hotel)

Diagram 6. Dynamics of structural change in Moscow quality room stock (2013–2019)



Source: Cushman & Wakefield, 2020

as well as "intragroup competition" from such niche products as apartments boasting higher liquidity and lower cost factors.

Modern-quality hotels completed in 2017-2019 are listed in Table 2. The list includes only the net gain and excludes properties that re-opened after renovation or were rebranded. 2019, for example, saw two such examples. The former Aquamarine Hotel re-opened in early 2019 as the Crowne Plaza Moscow-Tretyakovskaya, and later in the year the former Golden Apple hotel re-opened following a complete renovation as the Chekhoff Moscow Curio Collection by Hilton.

According to Cushman & Wakefield's research, in early 2020, when this study was being completed, there were as many as 4,700 modern-quality guest rooms under development or construction and due for completion before the end of 2025. Of these, some 3,500 rooms may be opened in the next three years. Table 3 lists the hotel projects with a high probability of completion over the mid-term.

[1] According to GOST R 51185-2014, a collective means of accommodation is a lodging facility (occupying a building, a portion of a building, or a space) used to offer accommodation services by legal entities or individual entrepreneurs. Collective means of accommodation include hotels and similar means of accommodation, specialized means of accommodation, and other accommodation facilities.

[2] Modern-quality hotel stock mostly includes hotels built in the post-Soviet period or substantially renovated during that period which provide the quality of accommodation and service expected by a modern traveler. The majority of modern-quality hotel rooms are branded or comply with international or domestic brands' standards.

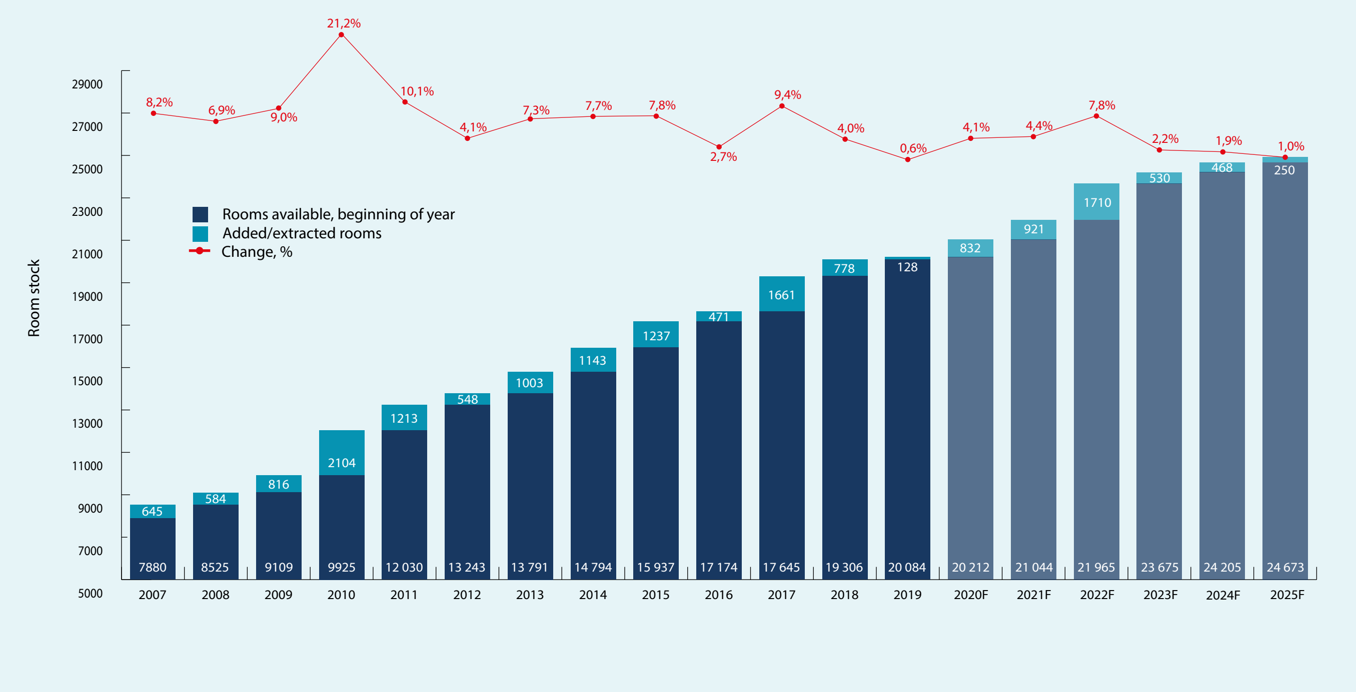
[3] All calculations are based on the room stock nominally opened in any given period.

Modern quality supply

Table 2. Modern-quality hotels completed in 2017-2019					
Name	Grade	Address	2017	2018	2019
Ibis Oktyabrskoe Pole	Economy	2 Marshal Rybalko St., Bldg. 5	240		
Ibis Budget Oktyabrskoye Pole	Budget	2 Marshal Rybalko St., Bldg. 5	114		
Hilton Garden Inn Krasnoselskaya	Midscale	11a Verkhnyaya Krasnoselskaya St.	292		
Azimut Moscow Smolenskaya Hotel	Midscale	8 Smolenskaya St.	474		
Hyatt Regency Moscow Petrovsky Park	Upper-Upscale	36 Leningradsky Prospect, Bldg. 33	298		
Holiday Inn Express Paveletskaya	Economy	33 Dubiniskaya St.	243		
Holiday Inn Express Khovrino	Economy	12 Levoberezhnaya St.		171	
Radisson Blu Olympiyskiy Hotel Moscow	Upper-Upscale	1 Samarskaya St.		379	
Pentahotel	Upscale	15 Novy Arbat St		228	
Holiday Inn Express Baumanskaya	Economy	2A Perevedenovsky Ln.			128
Total			**1661**	**778**	**128**

Source: Cushman & Wakefield, 2020

Diagram 7. Moscow hotel stock dynamics – actual and projected



Source: Cushman & Wakefield, 2020

Table 3. Modern-quality hotels expected to open in 2020-2022

Name	Grade	Address	2020	2021	2022
Marriott Imperial Plaza	Upper-Upscale	12 Krasnoprudnaya St., Bldg. 1	268		
Mövenpick	Upscale	70 Zemlyanoy Val St.	156		
NOVA Hotel	Midscale	24 Staroalekseevskaya St.	155		
Wyndham Garden Moscow	Midscale	6 Sadovo-Sukharevskaya St.	106		
Hampton by Hilton Rogozhskiy val 12	Economy	12 Rogozhsky Val St.	147		
Crowne Plaza Park Huaming	Upscale	14 Wilhelm Pieck St.		340	
Fairmont Moscow	Luxury	2 1st Tverskaya-Yamskaya St.		142	
DoubleTree by Hilton Moscow	Upscale	Nikitsky Blvd.		99	
Indigo	Upscale	24 Tverskaya St		100	
AC Hotel by Marriott	Upscale	8 Bolshaya Sadovaya St.		240	
Bvlgari Hotel	Luxury	9/15 Bol. Nikitskaya St.			65
Mandarin Oriental	Luxury	4-10 Sofiyskaya Emb.			65
Roza Rossa	Upper-Upscale	7 Zubovskaya St., Bldg. 1			91
Radisson Blu Leninsky Prospect	Upper-Upscale	90/2 Leninsky Prospect			150
M Gallery Zubovsky boulevard	Upper-Upscale	3 Zubovskaya St., 3, Bldg. 2			119
Hilton Moscow Poklonnaya	Upper-Upscale	3 Zubovskaya St., 3, Bldg. 2			163
Hilton Garden Inn Moscow Paveletsky	Midscale	2-4 Kozhevnicheskaya St.			245
Holiday Inn Volokolamskoye (Streshnevo)	Midscale	67 Volokolamskoe Hwy.			322
Toyoko Inn Krasnoselskaya	Midscale	15/17 1st Krasnoselsky Ln.			220
Novotel Comcity	Midscale	6 Kievskoye Hwy., Bldg. 1,			150
Ibis Moscow Semenovsky	Economy	34 Velyaminovskaya St., Bldg. 23			120
Total			**832**	**921**	**1710**

Source: Cushman & Wakefield, 2020

Modern quality hotels — operating results

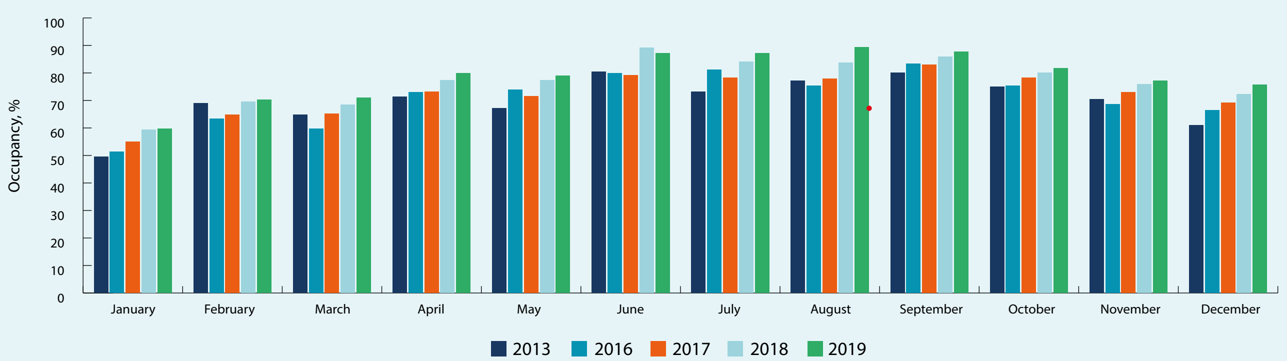
Following the 2018 FIFA World Cup, it took the Moscow market at least six months to find a new balance between supply and demand. As a result, Moscow hoteliers spent the first quarter of 2019 in a state of anxiety. The arrival of spring, however, brought with it the first signs of improved confidence levels — manifested in consistent monthly outperformance of occupancy levels compared to previous years. By the summer, it became clear that the increased demand for hotel accommodation — even when compared to the two summer months of the World Cup — was ready to set new records, giving Moscow hoteliers means to increase open rates. Despite the fact that the seasonality pattern typical for the Moscow market, with peaks and troughs typical of a business destination still discernible in Diagram 8, the monthly occupancy results of 2019 are clearly higher than those of the "benchmark" year of 2013. This is a direct consequence of a substantial surge in tourist demand (particularly during the warm months of the year, making the Moscow market almost like a resort location!), which allowed the city's hotels to increase occupancies over the weekends and other periods of traditional low demand.

Having said that, tourists generally demonstrate higher sensitivity to rates, so the growing share of the leisure tourist demand was also partially responsible for suppressing growth of the modern-quality hotel rates. Naturally, to extend this logic across all hotel price segments would be like taking the average temperature of all patients in a hospital. In fact, luxury hotels fared spectacularly well in August and September, when they could utilize all the advantages of their location (predominantly around the Kremlin) — highly attractive both for business and leisure travellers — and increase their rates by a higher margin than the market in general.

To be fair to the group leisure segment of demand, its growth in the overall composition of hotel demand was just one of the factors behind the sluggish growth of the annual ADR, which in 2019 was only 2.9% higher than in 2017 (from RUB 6,578 to RUB 6,759). Other significant factors were the increased number of hotels, which in 2017–2019 grew by nearly 2,500 rooms (while business-related demand stayed flat) as well as a 2% increase in VAT effective from January 1, 2019, part of which had to be absorbed by the hotels (particularly if VAT was included in the package rates offered by wholesalers).

Overall, the Moscow market ended 2019 on a high note. A buoyant start to 2020 (thanks to high levels of leisure demand during the New Year/Christmas holiday season and an earlier than usual start of the business

Diagram 8. Modern-quality market: monthly Occupancy in 2013, 2016–2019



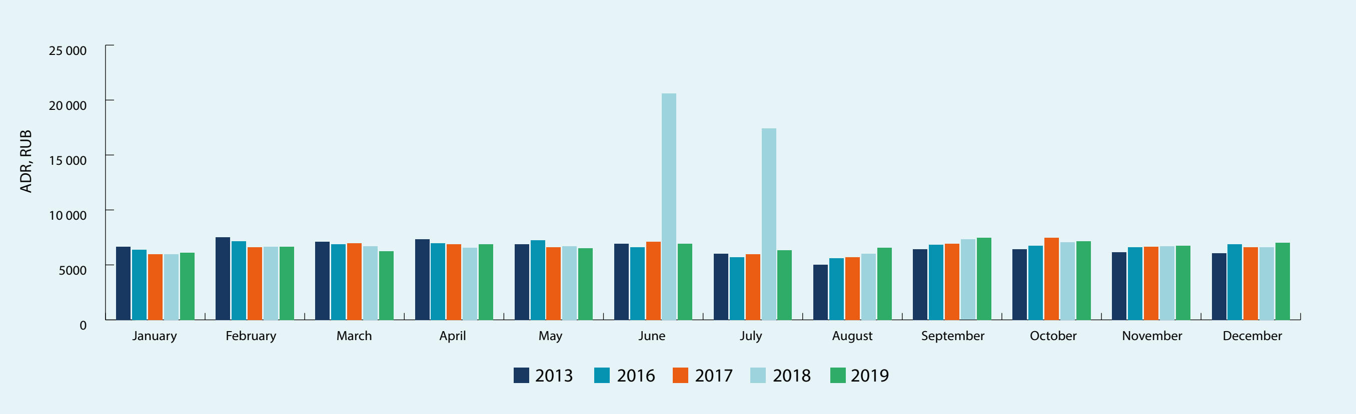
Source: Cushman & Wakefield, 2020

Modern quality hotels — operating results

season — in the second 10-day period of January) made hoteliers confident that they would be finally able to start focusing on yield management rather than on trying to sell as many rooms as possible. However, the rosy picture of the world as of late January 2020 and the "reasonably optimistic" projections rolled out by hotel managers suddenly came to a halt due to the coronavirus spinning out of control in China. The situation may ultimately affect not just the upcoming tourist season (and thus adjust operational projections of the hotels dependent upon the mass Chinese tourist demand, which is notoriously rate-sensitive), but also upset the balance of powers in the entire Moscow hotel market. As stated in Section "Demand in 2020 and beyond", at the time of this study, the full effect that COVID-19 may have on the hotel market and — in more general terms — on the tourist sector of Moscow's economy remains hard to gauge. However, if January was generally much more profitable for the city's hotels, February demonstrated the first signs of budget weakness. Considering that the share of Chinese visitors in recent years has reached a stable 35–40% of Moscow's total foreign demand, any reductions in the number of Chinese tourists can have a real effect on the overall occupancy levels and revenues of Moscow hotels.

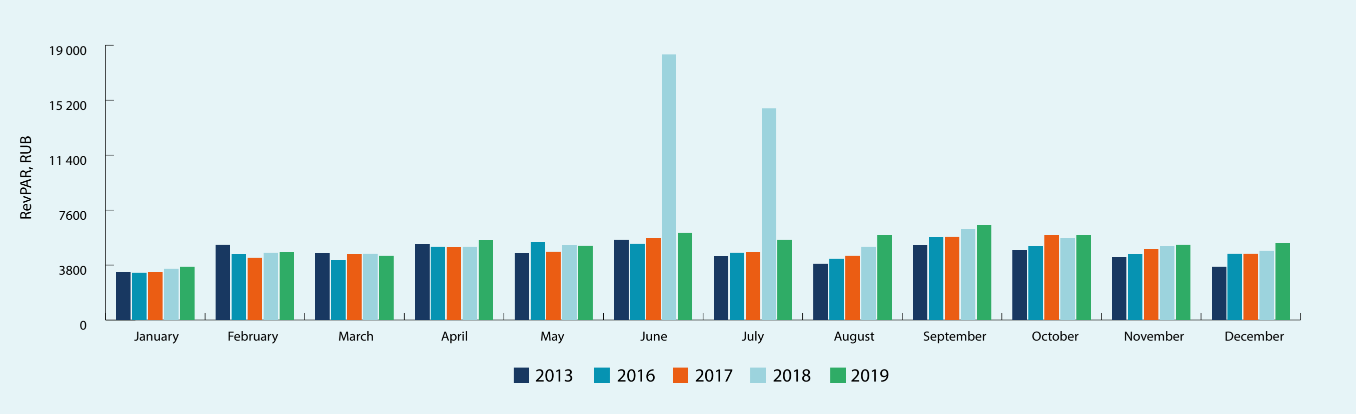
Thus, despite its energetic start, 2020 is unlikely to allow Moscow hotels to substantially improve their operating performance compared to 2019. With this in mind, by early February the majority of professionally operated modern-quality hotels had their "Plan B", outlining measures to battle the likely reduction in demand (and accounting for an expected substantial drop in visitation from China), strategies to replace lost business, and measures to tighten operating costs. Natural concerns about the immediate future of the operating business make owners and operators likely to postpone any planned capital expenditures... And who can blame them?

Diagram 9. Modern-quality market: monthly ADR in 2013, 2016-2019



Source: Cushman & Wakefield, 2020

Diagram 10. Modern-quality market: monthly RevPAR in 2013, 2016-2019



Source: Cushman & Wakefield, 2020

Table 4. Moscow modern-quality hotels – operating results

	2013	2014	2015	2016	2017	2018	2019
Occupancy, %	**68,5**	**63,7**	**67,7**	**72,4**	**72,8**	**76,6**	**78,0**
change, ppt		-4,8	4,0	4,7	0,4	3,8	1,4
ADR, RUB	**6002**	**5953**	**6430**	**6675**	**6567**	**8898**	**6759**
% change		-0,8	8,0	3,8	-1,6	35,5	-24,0
RevPAR, RUB	**4111**	**3790**	**4353**	**4830**	**4779**	**6816**	**5274**
% change		-7,8	14,9	11,0	-1,1	42,6	-22,6
Inflation, %	**6,8**	**7,8**	**12,9**	**5,4**	**3,7**	**2,9**	**4,5**

Source: Rosstat, Oxford Economics, Cushman & Wakefield, 2020

Hotel investment market

The Russian hotel investment market has seen minimal changes over the past year. Due to the lack of drastic improvements in the economic and political outlook both internally (low rates of actual and expected economic growth, volatility of the national currency) and externally (continued economic and political sanctions creating barriers for international investment) the Russian investment market effectively got stuck between the two worlds. On the one hand, the times of frantic supply and demand growth from 15 years ago are over, but on the other hand, the transparent and stable markets of the "old Europe" are still nowhere to be seen.

The circle of investors interested in buying Russian hotels is still small and mainly represented by the following groups:

- Large Russian specialized companies (including, but not limited to, Gleden Invest/AZIMUT Hotels, AFK Sistema, Kievskaya Ploschad, Safmar Group, KESKO, etc.) which often have their own hotel investment groups or hotel operating companies/brands. These hotel investors have a comprehensive understanding of the local market's realities and usually control costs well. These investors represent the largest group of market makers, and the geography of their interests can cover the entire territory of the Russian Federation (which is essential for companies continuing to expand their own brands).
- Foreign investors, including those from CIS countries, Southeast Asia, and the Middle East, that expect hotel investments in Moscow or St. Petersburg to produce higher returns than comparable investments in their own countries or in Europe. The share of these investors is noticeably smaller, and they are more focused on basic questions such as yields and returns, payback periods, and liquidity of hotel assets. Thus, their target markets are limited to Moscow and, in certain cases, St. Petersburg.
- Foreign investors owning their own hotel companies/brands for which buying hotels (or, more frequently, hotel development projects) is often the only way to enter the market. Recent examples of such investors are the Korean Lotte Group (Lotte Hotels & Resorts) and the Maltese International Hotel Investment Plc (Corinthia Hotels), which invested in properties in Moscow and St. Petersburg. The share of these investors, naturally, is rather small and unlikely to grow in the foreseeable future. Like the previous category of foreign investors, their interests are limited to the two largest, reliable, and liquid markets — Moscow and St. Petersburg.
- Non-specialized Russian investors who view hotel investments as a way to save and increase their personal wealth (particularly on the back of reduced profits and growing risks in other commercial property sectors such as offices and retail projects), limit political risks (compared to buying hotels abroad), or pursue other goals (e.g., increasing prices of residential units – generally, high-quality ones comprising part of the same mixed-use complex). These investors are generally the least predictable ones but, despite their non-systematic nature, their interests are still concentrated on assets located in the most reliable Russian markets – Moscow and St. Petersburg.

The investment rationale differs widely from one type of buyer to the next, making it difficult to understand or justify their asset pricing. The fact that the market remains thin also does not help the analysis. While over the past 24 months the database of RCA (Real Capital Analytics, one of the global analytical companies tracking investment volumes across all real estate classes in more than 170 countries) lists over 30 hotel deals of various types in the Russian Federation, the fact remains that not a single one of them may be called an investment-grade hotel transaction (i.e., a transparent, arms-length deal with a liquid and efficiently operated asset, etc.). The majority of recorded deals either feature hotel assets that comprise part of larger portfolio sales (making it difficult to measure actual hotel returns), or refinancing (as opposed to outright sales-and-purchase deals), or are, in fact, internal share swaps between investors.

Hotel investment market

According to Cushman & Wakefield, between 2008-2019 the Moscow market registered only 16 hotel investment deals with a total room count of nearly 4,000 rooms and a total investment volume just under $2.1 billion. Of these, only one deal was closed in 2019 – the sale of the hotel/residence development project at 10 Tverskaya St., formerly the Tsentralnaya Hotel). Finally, the closed nature of hotel investment deals (in which instead of bricks and mortar, a buyer acquires the operating business and thus many transactions occur directly on a principal-to-principal basis) makes hotel pricing difficult.

The limited amount of data available to hotel buyers to help them make informed decisions creates real risks for deals to fall though when pricing expectations of sellers and buyers do not match.

Nevertheless, drawing upon Cushman & Wakefield's professional experience in the main European markets and in Russia, as well as relying upon the investment deal data available to us, we assess the expected/required prime hotel yields to be in the following ranges: Moscow – 6-7%, St. Petersburg – 8-9%, other large Russian regional markets – 10-12%. Table 5 demonstrates how the prime hotel yields in Moscow and St. Petersburg compared to those in other major European markets - as of late 2019.

It should be noted that in several Moscow-based hotel deals registered in 2015-2016 the net initial yield was in the range of 4-7%. Why would investors accept a yield below that of traditional (and more liquid) financial instruments, despite a current trend for the Central Bank to lower the key lending rate (in early February 2020, it stood at 6.0%)? In Cushman & Wakefield's opinion, there may be several factors at play (individually or collectively):

1. With respect to hotels located in Moscow or St. Petersburg, in Cushman & Wakefield's experience, low levels of net initial yield may be reflective of buyers' expectations of an operational upside – either via active asset management or as a result of renovation/complete overhaul of a property in the "right location" (with physically deteriorated properties, however, estimating initial yields may be tricky);
2. Secondly, continued delay in hotel profitability levels returning to their pre-crisis (before 2014-2015) levels. This means that the net profits generated by the hotels are rarely sufficient to cover the initial investments (or may be sufficient assuming a very long payback period). To put it differently, an investor can still buy an operating hotel property at a price comparable or even lower than its replacement value (this is generally applicable to the hotels in regional markets).
3. Thirdly, a deficit of land parcels suitable for hotel development (especially critical for upper-upscale/luxury properties) as well as high project financing costs create real barriers to entry, making it more logical for investors to buy an existing property rather than build a hotel from scratch.
4. And, finally, a limited number of motivated sellers ready to dispose of existing properties (particularly those without substantial deferred CAPEX requirements). Due to the shortage of investment projects offering high returns in alternative economic sectors (including foreign markets), owners of modern-quality hotels see their operating business as a reliable source of cash flow with a potential upside (see Point 1 above).

The factors listed above generally explain the high level of interest from potential buyers for existing properties offered for sale, causing an initial yield compression effect.

Having said that, Cushman & Wakefield does not expect the Russian hotel investment market to see a meaningful increase in the number of hotel deals over the mid-term. The market remains thin and local. Even the two landmark hotel deals closed in 2019, if analysed closely, prove this point:

- The historic Tsentralnaya Hotel (formerly known as the Luxe Hotel), due to be fully redeveloped to feature a 50+-room upper-upscale/luxury hotel with 150+ residences for private accommodation, was sold in early 2019 by Safmar Group to a group of investors including MML (Viktor Rashnikov) and IHI Plc (owns and develops Corinthia Hotels). The deal size is estimated by market players to be RUB 3.5-4.0 billion.
- The sale of the historic Peking Hotel, announced in late 2019 by the media, was reported to be in final stages of closing, although full closing is scheduled for mid-2020. The seller is VTB Bank and the buyer is a domestic investor, the owner of the Zhemchuzhina Hotel in Sochi. While the deal size is not disclosed, hotel experts estimate it to be RUB 4-5 billion.

Upon a closer look, both hotel deals are in fact land acquisitions, albeit in landmark locations, where a hotel is just one of the elements of a mixed-use scheme. In the case of the former Tsentralnaya Hotel, return on investment will be improved by the expected sale of the residential units. In the Peking Hotel's case, the new concept for the historical property was not clear at the time of this analysis, but considering the high land value paid by the investor, it is unlikely, in Cushman & Wakefield's view, that sufficient levels of returns will be achieved by a hotel asset alone without more liquid and more profitable elements like apartments. One way or another, both deals indicate additional factors motivating buyers, which does not allow one to classify them as straightforward hotel deals.

To summarize the above trends, Cushman & Wakefield could only reiterate the conclusions drawn in the 2019 market overview. Any "tectonic shifts" in the Russian hotel investment market (mainly Moscow and St. Petersburg) able to make these markets less inwardly-oriented and more transparent are likely to take place only if there is an end to Russia's political and economic isolation. This would open it up to institutional-quality investors who could set clear pricing rules and create new demand for this type of asset.

Table 5. Prime Yield Ranges (%) — as of Q4 2019

Market	Managed	Vacant Possesion	Leased
Paris	4,00–4,50	3,75–4,25	3,00–3,50
London	4,00–4,50	3,75–4,25	3,50–4,00
Berlin	4,25–4,75	4,00–4,50	3,50–4,00
Munich	4,00–4,50	4,00–4,50	3,50–4,00
Frankfurt	4,50–5,00	4,25–4,50	3,50–4,00
Madrid	4,75–5,25	4,50–5,00	4,00–4,50
Zurich	4,25–4,50	4,00–4,50	3,75–4,00
Barcelona	4,75–5,25	4,50–5,00	4,00–4,50
Rome	4,75–5,25	4,50–5,00	3,25–3,75
Amsterdam	5,50–6,00	5,00–5,50	3,75–4,25
Vienna	4,75–5,00	4,50–4,75	3,75–4,25
Prague	5,00–5,50	4,75–5,25	4,00–4,50
Warsaw	5,50–6,00	5,25–5,75	4,50–4,75
Budapest	5,50–6,00	5,25–5,75	4,50–4,75
Bratislava	6,00–6,50	5,75–6,25	5,50–6,00
Moscow	**6,00–7,00**	**6,00–7,00**	**NA**
Bucharest	6,75–7,25	6,50–7,00	NA
Sofia	6,75–7,25	6,50–7,00	NA
Riga	7,00–7,50	6,75–7,25	6,00–6,50
Tallin	7,00–7,50	6,75–7,25	6,00–6,50
Vilnius	7,00–7,50	6,75–7,25	NA
Belgrade	7,00–7,50	6,75–7,25	NA
Saint Petersburg	**8,00–9,00**	**8,00–9,00**	**NA**
Baku	11,00–12,00	NA	NA

Source: Cushman & Wakefield, 2020

For notes

About Cushman & Wakefield

Cushman & Wakefield has been successfully operating in Russia since 1995 and currently employs more than 150 experienced and highly qualified experts. The Moscow office implements projects in all major cities in Russia and the CIS, forming transnational teams for solving complex tasks when necessary. There are 12 key areas of company activity, covering all the sectors of commercial real estate: offices, retail, warehouses, hospitality and tourism, land. The range of services provided includes the leasing of spaces, asset management, investment consulting, real estate operation, services for corporate clients, project management, development consultancy, representing tenant's interests, valuation, hospitality and tourism.

Cushman & Wakefield is one of the largest companies in the global commercial real estate market, with a turnover of $8.8 billion and a team of more than 53,000 specialists in more than 400 offices in 60 different countries.

For more information, visit our websites – www.cwrussia.ru and www.cushmanwakefield.ru

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