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MILAN, ITALY

UPSCALE HOTEL MARKET

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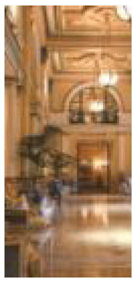

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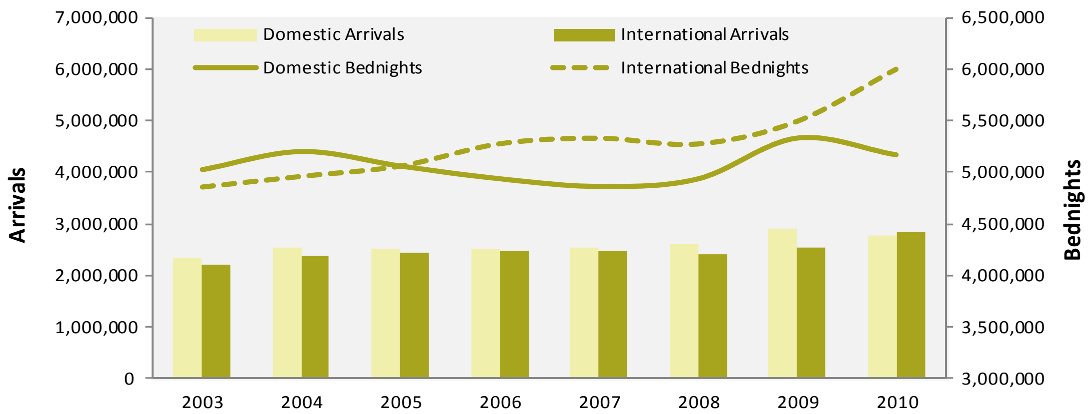
Summary

Milan is one of the key hotel markets in Italy, attracting both commercial and leisure travellers. Given recent concerns over the Italian economy and the political upheaval, Milan could be considered a good indicator of the true strength of the Italian economy. In this article we present recent tourist visitation trends in the Milan market and consider the upscale hotel performance for the last three years. We also present our performance forecast up to 2016 and discuss the current values of hotels in Milan.

Demand

Since 2003 domestic **arrivals** have registered a compound annual growth rate (CAGR) of 2.5% with the highest increase in 2009 (12%) followed by a contraction of 4% in 2010. International arrivals have constantly increased at an average of 3% per annum between 2003 and 2007 and, after declining by 3% in 2008, have registered a growth of 6% and 11% in 2009 and 2010 respectively. The proportion of domestic and international arrivals has remained practically unchanged since 2003 at a well balanced 50% each. This demonstrates a strong and stable market which has proven to be resilient against the global economic downturn.

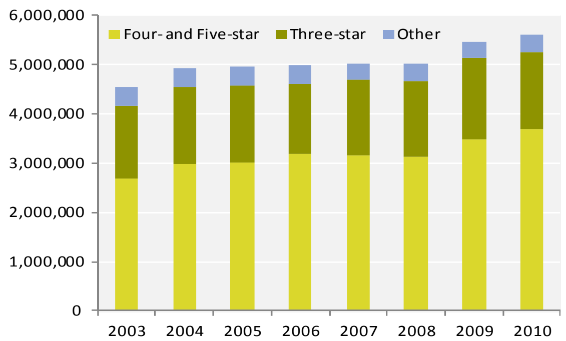
FIGURE 1: ARRIVALS AND BEDNIGHTS AT HOTELS – MILAN



Domestic Arrivals CAGR	2.5%
International Arrivals CAGR	3.6%
Combined Arrivals CAGR	**3.1%**

Domestic Bednights CAGR	0.4%
International Bednights CAGR	3.1%
Combined Bednights CAGR	**1.8%**

FIGURE 2: ARRIVALS AT HOTELS BY CATEGORY



CAGR	
Five- and Four-star	4.6%
Three-star	0.9%
Other	-1.0%
Combined	**3.1%**

The total number of **bednights** grew by 1.8% between 2003 and 2010, mainly driven by a growth in international visitors while domestic bednights remained unchanged. The **average length of stay** also remained unchanged over this period, at around 2.0 nights for both domestic and international travellers.

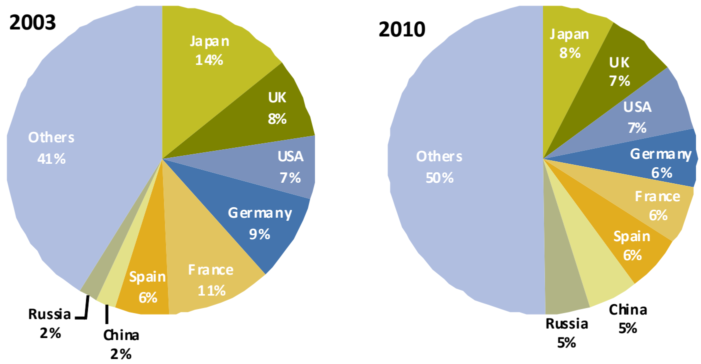
Figure 2 shows that total arrivals varied between different hotel categories; between 2007 and 2010 four- and five-star hotels registered a combined CAGR of 4.6%, three-star hotels of 0.9% while other hotel categories registered a decrease of 1.0%. This suggests a strong and growing demand for five-star and luxury accommodation.

In 2010, arrivals from two of the main source countries, Japan and the UK, decreased compared to 2003, while arrivals from the USA and from emerging countries such as China and Russia tripled over the same period (albeit from a comparatively small base). Foreign visitation to Milan has further diversified since 2003, as demand from various other regions – notably Central and Eastern Europe, Brazil, Australia and the Middle East – picked up. This demand still remains proportionally small, nevertheless. It does, however, demonstrate the wide appeal of the Milanese market. More importantly, this diversification should provide further stability and increased demand going forward. Figure 3 shows the key changes from 2003 to 2010.

FIGURE 3: MAIN SOURCE COUNTRIES 2003 AND 2010

Source Countries	2003	2010
Japan	311,517	217,376
UK	185,275	203,637
USA	143,186	195,177
Germany	203,773	172,269
France	240,960	171,681
Spain	119,667	165,705
China	46,283	150,101
Russia	43,704	128,495
Others	908,586	1,426,479
Total	**2,202,951**	**2,830,920**

Source: Istat 2011

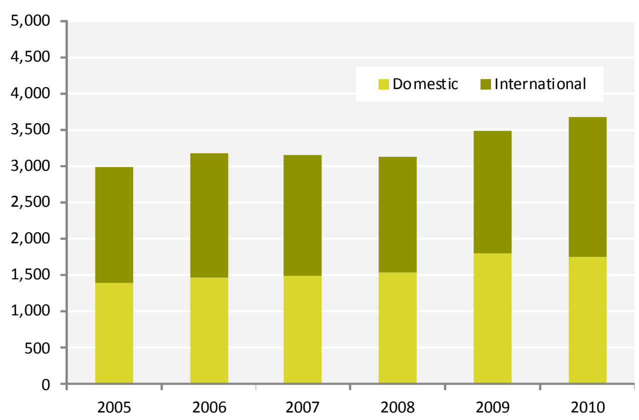


Demand Trend – Luxury Segment

Despite being mainly a business-driven destination, Milan has shown a certain resilience to the global economic downturn in terms of hotel demand. Demand for luxury and upscale hotel accommodation in the city has remained stable at an average of approximately 3 million arrivals between 2005 and 2008, reaching a total of approximately 3.5 million in 2009, an increase of almost 12.0%. Available data show an increase in overall arrivals at Milanese hotels of almost 6.0% in 2010. Statistics available for Italy in the first eight months of 2011 also show a positive growth trend, albeit moderate, with an increase in bednights of approximately 2.0% over the same period in 2010.

Demand for hotel accommodation remained stable in Milan between 2004 and 2008 with a 9.0% increase in 2009.

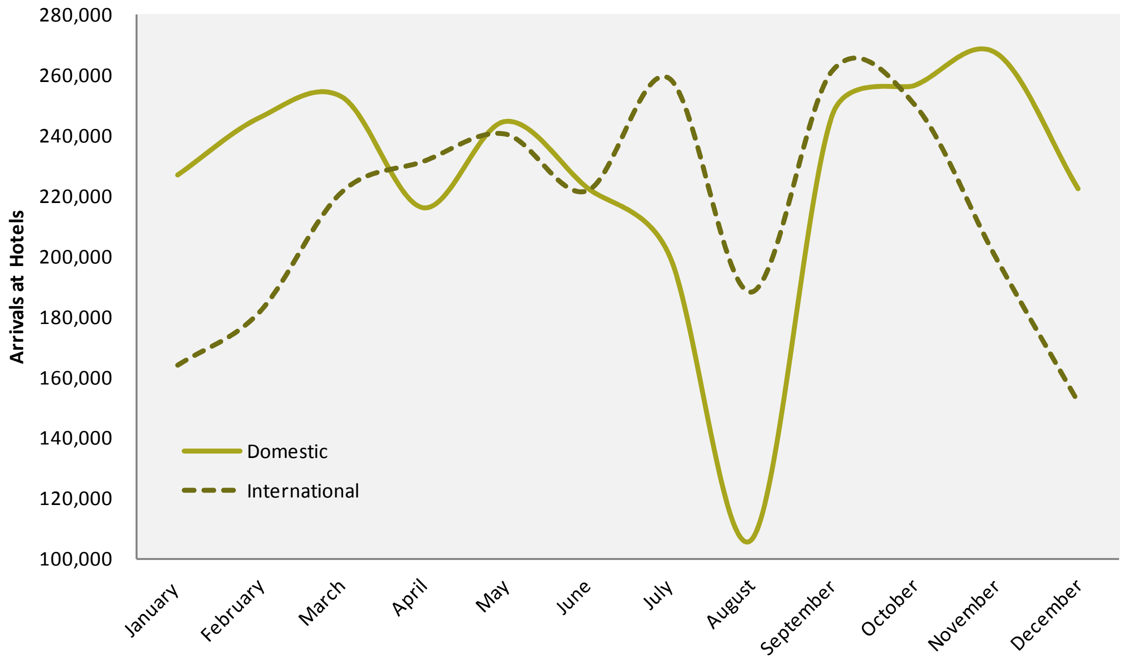
FIGURE 4: DOMESTIC AND INTERNATIONAL ARRIVALS AT LUXURY AND UPSCALE HOTELS (000S)



SOURCE: ISTAT

The **seasonality** of demand, depicted in the following graph, shows that domestic and international demand follow a similar trend although with some more pronounced drops in the summer for the domestic market and during the winter for the international demand.

FIGURE 5: SEASONALITY – 2007-10



Source : Istat

As illustrated in the graph, Milan experiences the expected seasonality trend for a city that is the financial and business centre of the country, with high demand from February to June and from September to November. Although domestic demand decreases during the summer season due to the slowdown in business activity, international leisure demand ensures that the level of arrivals remains at reasonable levels throughout July and August.

Supply

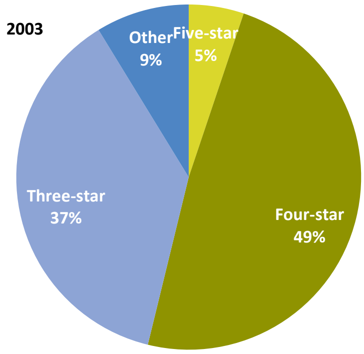
The total number of hotel rooms in Milan increased by 2% to approximately 38,300 between 2007 and 2010. For comparison, Rome has 47,000 rooms, Paris 77,000 and London 90,000. This increase is mainly driven by an increase of 19% in the four-star category while the five-star category was stable at around 1,900 rooms. Lower hotel categories registered a decrease of approximately 15%. Consequently, the share of four-star rooms has increased from 44% to almost 56.6% whilst the three-star and other categories experienced decreases in rooms inventory of around 6% and 23%, respectively.

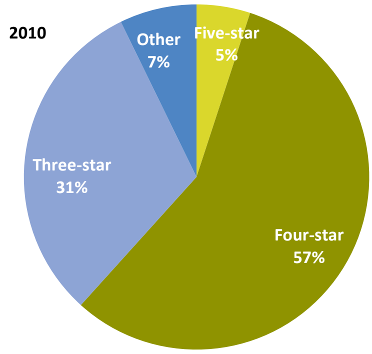
With the strong and steady visitor growth and the new source countries, the existing five-star supply might not be sufficient for future demand.

FIGURE 6: HOTEL SUPPLY PER CATEGORY 2003 AND 2010

Category	2007	2010	% Change
Five-star	1,930	1,922	0%
Four-star	18,201	21,698	19%
Three-star	14,000	11,898	-15%
Other	3,276	2,769	-15%
Total	**37,407**	**38,287**	**2%**

Source: Istat





In summary, demand across the market has risen by approximately 12% and supply by 2% for the period of 2007 to 2010. Demand in the luxury segment over the same period grew by almost 17%.

Supply Trend - Luxury Segment

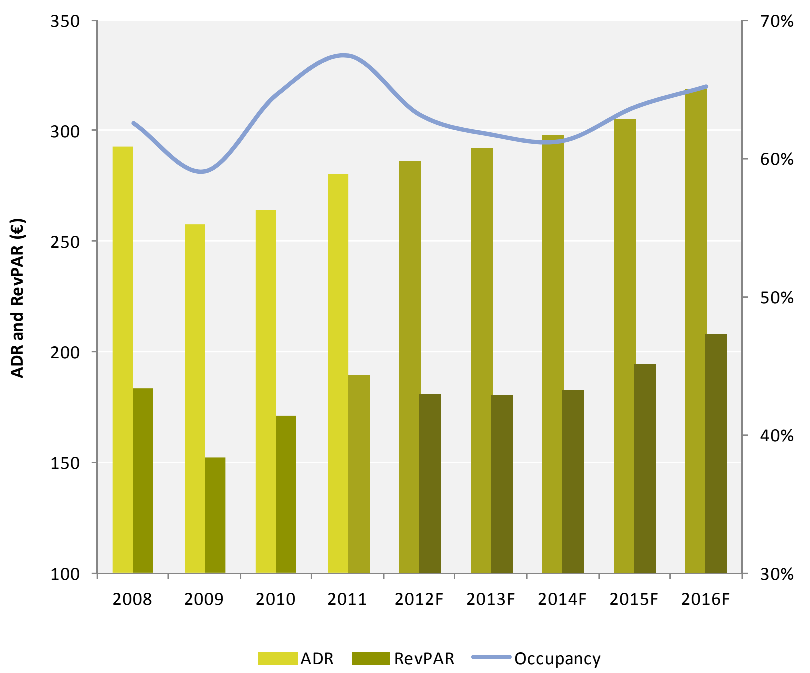
In regards to **Supply**, there had been no hotels added to this segment in recent years, but this changed in 2010 and further new supply is expected until 2014. New openings in 2010 included the 63-room boutique hotel Maison Moschino (opened in March) and the 250-room Radisson Blu (opened in April). November 2011 saw the opening of the 95-room second Armani Hotel (the first one being in Dubai). New supply in the five-star and luxury market will continue with the expected openings of the 76-room W Milan and the 104-room Mandarin Oriental in early 2014. The project for an 80-room InterContinental Duomo, also expected for early 2014, has been further delayed and will not probably materialise. In addition, after being closed for renovation for two and a half years, the Grand Hotel Gallia is expected to re-enter the market with approximately 240 rooms at the beginning of 2013. Such an increase of new supply to a reasonably static market will take some years to absorb, but given the increasing demand it should result in a strong market.

FIGURE 7: ARMANI HOTEL MILAN – OPENED 10 NOVEMBER 2011

Recent and Forecast Upscale Hotel Performance

Our analysis takes into account the historical performance of a sample of upscale hotels in Milan totalling approximately 2,000 rooms. We analysed occupancy and average rate performance between 2009 and 2011. The additions to the room inventory have been considered in our forecast and are expected to have an impact on occupancy levels as well as on average rate growth. Figure 8 illustrates the historical and forecast projections for the defined competitive market.

FIGURE 8: USPCALE HOTEL PERFORMANCE 2009-16

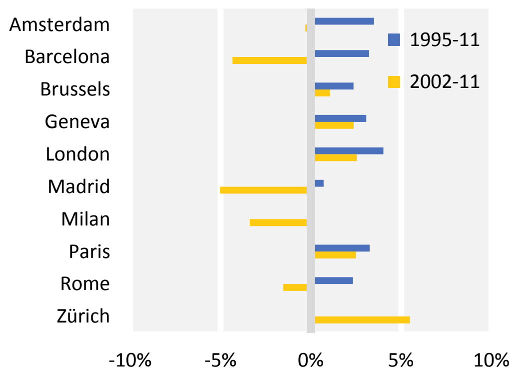


Even though average rate is not yet back to 2008 values, overall luxury hotel performance in Milan for 2011 showed clear signs of growth in occupancy and consequently RevPAR. After decreasing in 2009, the growth of nearly 10% in both occupancy and rate achieved in 2011 has resulted in an increase of approximately 18% in RevPAR. Occupancy is forecast to decrease from 2012 to 2014 owing to the impact of new supply entering in the market while average rate is forecast to constantly increase. This results in RevPAR decreasing in 2012 and 2013 when the decrease in occupancy is not offset by the increase in rate. We note that the EXPO taking place in Milan between May and October 2015 is expected to have a positive effect on both occupancy and average rate in that year. We consider a few more years will be necessary for the market to absorb the new supply expected to enter the market between 2011 and 2014.

Current and Future Values

As detailed in our European Hotel Valuation Index report (see Figure 9), the combination of hotel performance and investment appetite for the Milan market resulted in an increase in values per room of almost 4% in 2011, after four years of decreases in value. Milan was therefore ranked as ninth in the 2011 European Valuation index at €286,100 per room.

FIGURE 9: VALUE CHANGES IN THE MAIN EUROPEAN MARKETS



Italy, in general, is relatively modest in terms of volume of transactions. In 2011 no meaningful transactions were registered. There are approximately 33,000 hotels in Italy, but few of these even come into the radar of international investors as they are mainly owned by wealthy families who seldom put them on the market. The constraints of the physical inventory might pose an additional challenge to international hotel operators. Lastly, the complexities of the fiscal and legal framework in Italy might pose, to some degree, a further barrier to entry.

FIGURE 10: VALUE FORECAST CHANGES IN THE MAIN EUROPEAN MARKETS

	HVS Forecast				
City	2012	2013	2014	2015	2016
Amsterdam	300,000	320,000	340,000	350,000	350,000
Barcelona	240,000	260,000	280,000	290,000	300,000
Brussels	180,000	190,000	190,000	190,000	200,000
Geneva	470,000	480,000	480,000	490,000	490,000
London	620,000	640,000	650,000	670,000	690,000
Madrid	220,000	220,000	230,000	250,000	260,000
Manchester	150,000	150,000	160,000	170,000	180,000
Milan	300,000	320,000	350,000	370,000	380,000
Paris	650,000	660,000	670,000	690,000	700,000
Rome	380,000	400,000	420,000	440,000	450,000
Zürich	520,000	530,000	530,000	540,000	540,000

Source: HVS – London Office

We note, however, that three hotels are currently for sale in the suburban area of Milan: the 436-room Crowne Plaza Milan Linate, the 142-room Holiday Inn Linate and the recently refurbished 203-room Holiday Inn Assago.

Conclusion

Milan is an established international market driven mainly by business demand, which nevertheless also attracts a share of leisure tourism, mainly for high-end shopping purposes. Although the pipeline of new supply, with almost 560 rooms in the upscale segment, is forecast to have a short-term negative impact on market-wide occupancy levels, the market is expected to recover by 2016, and to continue to hold its privileged position as Italy's financial and fashion capital. If the Milan hotel market is an indicator of the Italian economy as a whole, there would be a slow, steady recovery and growth due to strong demand from existing and new markets. We're sure many Italian politicians and investors could accept that!

About HVS

HVS is the world's leading consulting and services organisation focused on the hotel, restaurant, shared ownership, gaming, and leisure industries. Established in 1980, the company performs more than 2,000 assignments per year for virtually every major industry participant. HVS principals are regarded as the leading professionals in their respective regions of the globe. Through a worldwide network of 30 offices staffed by 400 seasoned industry professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. For further information regarding our expertise and specifics about our services, please visit **www.hvs.com**.

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About the Authors

Liliana Ielacqua is an associate at HVS Consulting & Valuation in London. Originally from Italy, Liliana joined the company in 2008 after completing her Masters degree in Real Estate Finance and Investment at Cornell University's School of Hotel Administration. Since joining HVS, she has conducted several feasibility studies, valuations and market research studies across Europe, and has written market and industry-related articles on several Italian markets.

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