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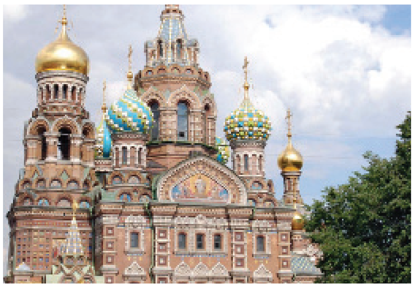
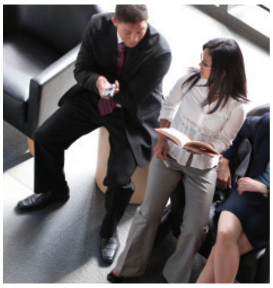
RUSSIA, THE CIS AND GEORGIA
HOTEL VALUATION INDEX 2013

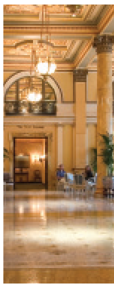
Tatiana Veller
Managing Director

Alexey Korobkin
Associate Director

Margarita Lobova
Consultant







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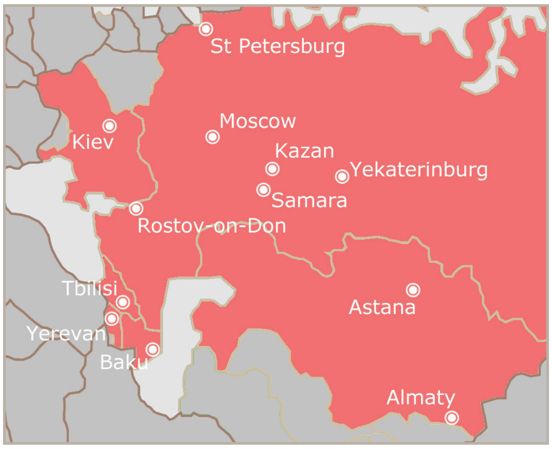
See reverse for details

Plummeting hotel performance and cloudy yet ever changing market conditions make hotel investment in Russia and the CIS an exciting but potentially costly venture. In this publication, HVS provides a guide though the peaks and troughs of the various markets, giving operators, investors and owners a clearer view of the region from a valuation perspective.



Introduction

Even though for the last 24 months the majority of reviewed markets have demonstrated positive growth, 2013 proved to be a year of contrasts. Some markets continue to show signs of recovery from previous decreases (Astana, St Petersburg, Rostov-on-Don, Samara, Yekaterinburg, Tbilisi, Kazan) owing mostly to renewed business activity leading to more room nights and an improved investor sentiment; however a few markets are still struggling to recover. Up to now, the main pressure on markets was in relatation to average rates and the sensitivity of guests to any increase, preventing values from recovering faster. Even though hotel performance in Russia, the CIS & Georgia has not been outstanding for the past year, the growth rate in average value per room has still outperformed the European one by 2%.

This issue includes:

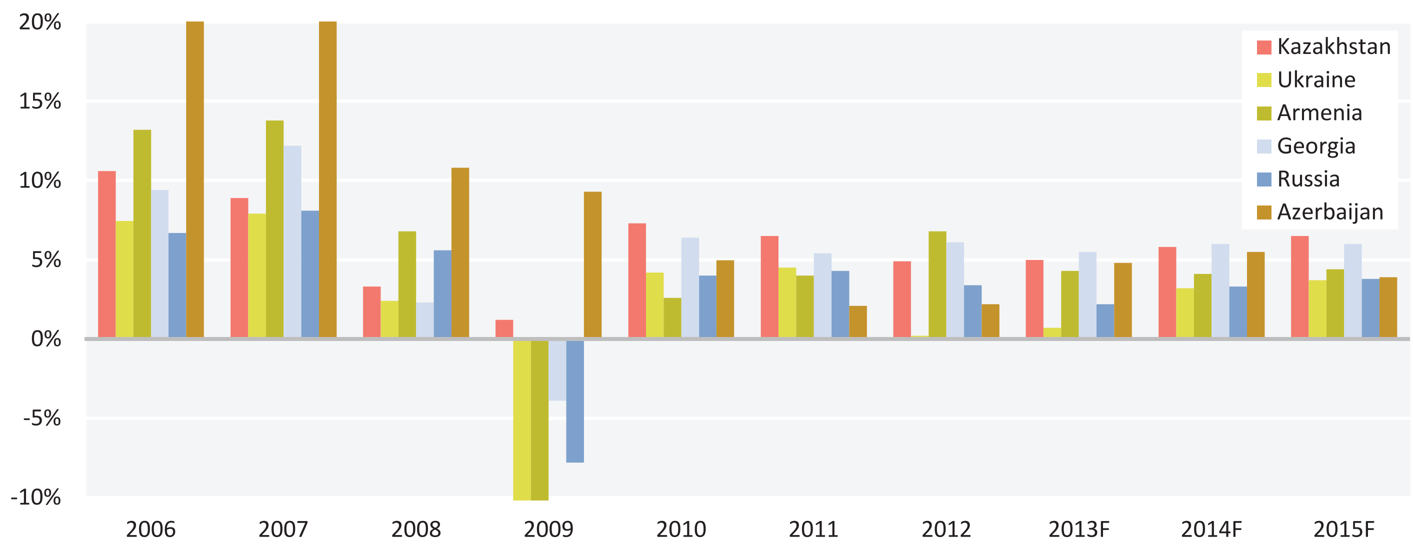
- **Hotel values continue to recover**
- **Five-year forecast**
- **Volatility Index**

For the first time, we have introduced the Volatility Index into the Russia, the CIS & Georgia HVI. This additional tool will allow investors to better gauge which hotel markets offer more stable environments.

Economic Overview of the Region

After a relatively strong economic performance in 2012, which exceeded the growth of emerging economies such as Brazil and Turkey, Russia's GDP growth slowed significantly in 2013. The solid results of 2012 were explained by a decline in the capital outflows, a balanced budget, a low indicator of public debt compared to western countries, low unemployment rates combined with high wage growth and the moderate pace of inflation. However, in 2013, fiscal tightening, restrictive monetary policy, stagnant oil prices and weak external demand have led to GDP growth of only 1.6% in the first quarter, according to Rosstat. Even though such performance had been predicted and can to a certain extent be explained by the high base of the previous year, this indicator is still the lowest since the fourth quarter of 2009.

CHART 1: GDP GROWTH FORECAST



Source: Economist Intelligence Unit

Several major political events have taken place in the region in 2013 and will have an impact on the economic situation in the region and its attractiveness to investors. Even though the president of Armenia has won the dispute over the results of the elections held in the beginning of the year, the situation still cannot be called stable. Instead of developing a free trade relationship with the EU, Armenia has agreed to join the Customs Union with Russia, Kazakhstan and Belarus. This will allow Armenia to get better exposure to these markets and advance its security; however, this may also have jeopardised its relationship with the EU. Despite this, the outlook for Armenia's economic growth remains quite positive.

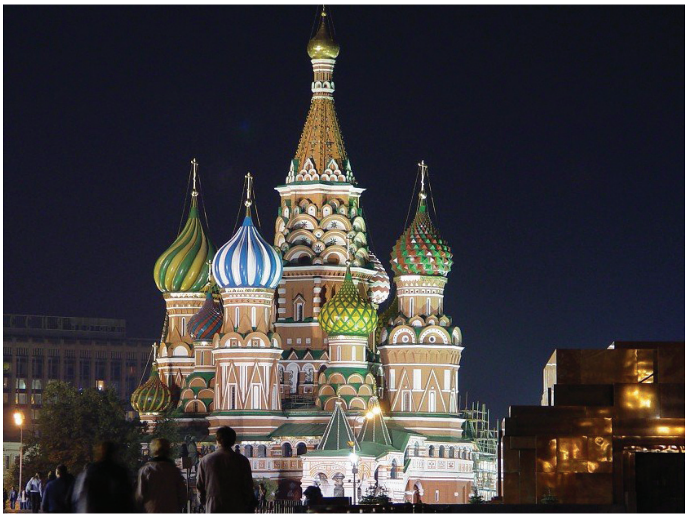
Azerbaijan's presidential elections are scheduled for October 2013. Analysts are quite certain of the re-election of the current president, Ilham Aliyev. In the next four years, growth of the country's economy will slow down compared to the high growth experience in recent years that was driven by high oil prices. Oil production will slow down in the medium term; however, while growth may slightly accelerate in the country, mostly due to the development of the non-energy sector, GDP growth will not exceed 5%.

Georgia's political situation may be characterised as unstable at the moment. Despite the fact that the new government is pushing the country towards democracy, policies and strategies that would attract foreign investors and would cause growth of the country's economy are not yet in place. Georgia's GDP growth rate slowed to 1.7% in the first half of 2013, reflecting investor caution linked to the political transition, delays in public infrastructure projects, weak domestic demand and slower global growth.

The situation in Kazakhstan seems to be the most stable in the region as no changes in political strategies are foreseen; however, the fact that there is no obvious succession plan might cause some long-term political uncertainty. Economic growth may accelerate due to the development of a major new Caspian Sea oil field.

MARIINSKY PALACE, ST PETERSBURG

SAINT BASIL'S CATHEDRAL, MOSCOW



According to Moody's regional outlook, the output of the CIS countries will grow at faster levels than post-crisis indicators; however, these levels will remain moderate and will not reach pre-crisis levels in the midterm. The lowest growth rates are expected in Ukraine, while Kazakhstan and Georgia are forecast to show the best performance in the region. The economy of the CIS region will slow down due to the stagnation of Belarus's economy and the slow GDP growth in Ukraine. Development of Kazakhstan will remain stable due to the exploration of new mineral resources. The major weakness of the region's economic system is lack of diversification and heavy dependence on the energy sector and commodity prices, which in turn makes the region highly sensitive to the situation in the EU and global developments affecting the commodity markets. While Azerbaijan, Kazakhstan and Russia are exporters of energy products, the rest of the countries are importing them and hence are negatively affected by high energy prices. In general, it is expected that demand for the region's export will decline and the investment capital outflow will increase, which will lead to depreciation of the local currencies.

The cities covered in the report are: Moscow, St Petersburg, Yekaterinburg, Rostov-on-Don, Samara and Kazan (Russia); Kiev (Ukraine); Baku (Azerbaijan); Astana and Almaty (Kazakhstan); Tbilisi (Georgia); and Yerevan (Armenia).

As a consequence of the political and economic instability and difficulties, Ukraine and Belarus are in a position of current-account deficit that may lead to the currency crisis. The Ukraine

CHART 2: HISTORICAL VALUES PER ROOM – RUSSIA, THE CIS AND GEORGIA (€)

	2007	2008	2009	2010	2011	2012	2013
Moscow Upscale/Luxury	498,000	527,000	327,000	353,000	385,000	402,000	384,000
St Petersburg Upscale/Luxury	358,000	377,000	213,000	222,000	234,000	240,000	267,000
European Average	274,000	244,800	212,000	215,000	240,400	240,300	238,000
Moscow Mid-Market/Budget	294,000	292,000	204,000	201,000	207,000	223,000	218,000
Tbilisi	273,000	213,000	156,000	153,000	155,000	188,000	205,000
Astana	329,000	224,000	179,000	152,000	166,000	151,000	184,000
Kiev	427,000	376,000	194,000	201,000	246,000	188,000	173,000
Average – Russia, the CIS and Georgia	**264,714**	**239,000**	**159,000**	**152,900**	**166,000**	**164,000**	**166,000**
Baku	292,000	245,000	205,000	200,000	198,000	156,000	142,000
Almaty	418,000	293,000	190,000	152,000	165,000	147,000	126,000
Kazan	119,000	130,000	102,000	86,000	98,000	107,000	113,000
Samara	156,000	145,000	88,000	91,000	98,000	101,000	112,000
Yekaterinburg	143,000	148,000	106,000	82,000	89,000	99,000	109,000
Yerevan	134,000	100,000	85,000	86,000	97,000	106,000	102,000
St Petersburg Mid-Market/Budget	139,000	137,000	81,000	83,000	94,000	94,000	98,000
Rostov-on-Don	126,000	133,000	96,000	79,000	87,000	93,000	95,000

Source: HVS

hryvna depreciated 1.5% and the Belarus ruble 5.5% against the US dollar in 2013, according to Bloomberg. By comparison, their Eastern European neighbours Poland and the Czech Republic have dropped less than 1%.

The Russian ruble depreciated significantly in summer 2013 as a result of the Ministry of Finance's claim that it has started acquiring the currency for the Reserve Fund. According to the central bank, as at year-to-August 2013 the price of the dual currency basket (euro and US dollars) has increased by 8%. Some analysts have predicted devaluation of the national currency. Another reason for the weakening of the ruble was the significant outflow of the private capital that was witnessed in 2013; however, according to government officials, this will slow down in 2014 from US$70 billion to US$25 billion. Such local currency fluctuations will significantly affect performance of the tourism industry, and specifically hotel operational results. The foreign-exchange losses will have a deeper impact on a property's bottom line for the full year, with quite a visible net profit decrease.

Analysing the Numbers

As in previous editions of the HVI, we continue with the analysis of the average hotel values per room for several key cities in Russia, the CIS and Georgia (each market is discussed briefly in the following section). HVS has tracked value trends from 2007, as outlined in Chart 2, with the corresponding annual changes in Chart 3. As in previous publications, we consider only the Moscow and St Petersburg hotel markets to be mature enough to differentiate among the luxury/upscale and mid-market/budget segments. To date, the rest of the described markets are not diversified enough to describe them by particular segments.

Traditionally, the Moscow Upscale/Luxury segment has held first position in the market (ranked as of 2013). Even though hotel operational performance in the city has not been outstanding this year, Moscow's Upscale/Luxury segment still achieves one of the highest average rates in Europe, and indeed the highest rate in the region, hence the values per

CHART 3: WINNERS AND LOSERS

Growth/Decline	2008	2009	2010	2011	2012	2013
Astana	-32%	-20%	-15%	9%	-9%	+22%
St Petersburg Upscale/Luxury	5%	-44%	4%	5%	3%	+11%
Samara	-7%	-39%	3%	8%	3%	+11%
Yekaterinburg	3%	-28%	-23%	9%	11%	+10%
Tbilisi	-22%	-27%	-2%	1%	21%	+9%
Kazan	9%	-22%	-16%	14%	9%	+6%
St Petersburg Mid-Market/Budget	-1%	-41%	2%	13%	0%	+4%
Rostov-on-Don	6%	-28%	-18%	10%	7%	+2%
Average – Russia, the CIS and Georgia	**-10%**	**-33%**	**-4%**	**9%**	**-1%**	**+1%**
European Average	-11%	-13%	1%	12%	0%	-1%
Moscow Mid-Market/Budget	-1%	-30%	-1%	3%	8%	-2%
Yerevan	-25%	-15%	1%	13%	9%	-4%
Moscow Upscale/Luxury	6%	-38%	8%	9%	4%	-4%
Kiev	-12%	-48%	4%	22%	-24%	-8%
Baku	-16%	-16%	-2%	-1%	-21%	-9%
Almaty	-30%	-35%	-20%	9%	-11%	-14%

Source: HVS

room are still at a high level of €384,000 in 2013. In 2012, the Moscow Upscale/Luxury market showed a healthy increase in occupancy and average rate, which led to a rise in values. However, this year we forecast a slight decrease in marketwide average rate, which is the main reason behind the fall in values. The only addition to luxury supply was the opening of the Kempinski Nikolskaya. Second in the table is the St Petersburg Upscale/Luxury segment, ranked just above the European average. Despite the strong seasonality factor, St Petersburg's upscale/luxury market managed to improve its performance in 2013, which led to an increase in the value per room to €267,000.

CHART 4: VALUE RANKINGS

	2007	2008	2009	2010	2011	2012	2013	2018
Moscow Upscale/Luxury	1	1	1	1	1	1	1	1
St Petersburg Upscale/Luxury	4	2	2	2	4	3	2	2
European Average	8	7	3	3	3	2	3	4
Moscow Mid-Market/Budget	6	5	5	5	5	4	4	3
Tbilisi	9	10	10	7	10	6	5	5
Astana	5	9	8	9	7	9	6	6
Kiev	2	3	6	4	2	5	7	8
Average – Russia, the CIS and Georgia	**10**	**8**	**9**	**8**	**8**	**7**	**8**	**7**
Baku	7	6	4	6	6	8	9	14
Almaty	3	4	7	10	9	10	10	9
Kazan	16	15	12	12	12	11	11	15
Samara	11	12	14	11	11	13	12	12
Yekaterinburg	12	11	11	15	15	14	13	10
Yerevan	14	16	15	13	13	12	14	13
St Petersburg Mid-Market/Budget	13	13	16	14	14	15	15	11
Rostov-on-Don	15	14	13	16	16	16	16	16

Source: HVS

The continuing turmoil in the European economy is reflected in the performance of the hotel markets, and hence the stagnation and even slight depreciation of the European average value per room for the second year in a row.

In Almaty, Kiev and Baku, the operational performance of hotels has been weaker than expected and continued to fall for the second year in a row. This situation is explained by the existence and recent opening of a large number of upscale/luxury hotels in all three markets, a troubled economy in Ukraine, and stagnant demand for hotels in Almaty and Baku. Hence the values per room in those cities have been reviewed downwards. Meanwhile, Tbilisi has shown stronger than expected results, which led it to be ranked fourth in the region in 2013 with a value per room of €205,000. Values in almost all of the other markets have kept growing; however, at a slower than expected pace, with Russian regional cities taking most of the bottom places in the table and CIS capitals populating the middle of it.

When looking at the annual changes in value (Chart 3), 2013 proved to be a year of contrasts –some markets continued to show signs of recovery from previous decreases (Astana, St Petersburg, Samara, Yekaterinburg and others), owing mostly to renewed business activity leading to more room nights and improved investor sentiment. However, a few markets are still struggling to recover. Unexpectedly negative results were seen in both of Moscow's market segments. The pressure on average rates that has been witnessed since the 2008 economic crisis is forecast to outweigh demand growth in 2013, especially in Upscale/Luxury segment, which will result in a drop in RevPAR and hence lead to a decrease in the value per room from €402,000 to €384,000 in the Upscale/Luxury segment and from €223,000 to €218,000 in Mid-market/Budget segment. Despite the generally stable political and economic situation in Kazakhstan, we can see from the Chart 3 that the biggest 'loser' this year is Almaty, while the biggest 'winner' is Astana. Such opposite movement within one country may be explained by the fact that business and government travel that is a major source of demand for the hotels in Kazakhstan is steadily shifting from an old capital to the new one, and hence the operational performance of Almaty is suffering while Astana's is improving, leading to the decrease of Almaty's value per room from €147,000 in 2012 to €126,000 in 2013 and an increase of Astana's value per room from €151,000 to €184,000. Astana is preparing for Expo 2017 and saw no new

ROSTOV-ON-DON

CHART 5: HISTORICAL AND FORECAST VALUES PER ROOM IN EURO AND YEAR-ON-YEAR PERCENTAGE CHANGES

	2007	2008	2009	2010	2011	2012	2013	2018	CAGR 2007-13	CAGR 2014-18
Almaty	418,000	293,000	190,000	151,906	165,000	146,908	126,119	178,681	-18.1%	7.9%
Astana	329,000	224,000	179,000	151,930	166,040	151,500	183,878	224,244	-9.2%	11.2%
Average – Russia, the CIS and Georgia	**265,000**	**239,000**	**159,000**	**153,000**	**166,000**	**164,000**	**166,000**	**209,000**	-7.5%	6.4%
Baku	292,000	245,000	205,000	200,000	198,000	155,619	142,445	139,520	-11.3%	3.1%
Kazan	119,000	130,000	102,000	86,176	97,716	107,108	113,367	136,232	-0.8%	2.8%
Kiev	427,000	376,000	194,000	200,895	246,319	187,587	173,130	194,305	-14.0%	5.3%
Moscow Mid-Market/Budget	294,000	292,086	203,654	201,061	207,442	223,428	218,157	271,903	-4.9%	5.6%
Moscow Upscale/Luxury	498,000	527,157	327,276	353,090	385,000	401,995	383,905	508,105	-4.2%	8.4%
Rostov-on-Don	126,000	133,000	96,000	79,000	87,000	92,588	95,175	95,017	-4.6%	1.7%
Samara	156,000	145,000	88,000	91,266	97,636	101,174	111,773	144,042	-5.4%	4.4%
St Petersburg Mid-Market/Budget	139,000	137,319	81,391	83,085	94,315	93,755	97,744	145,116	-5.7%	9.8%
St Petersburg Upscale/Luxury	358,000	377,385	212,659	221,769	234,000	239,504	267,126	352,548	-4.8%	8.3%
Tbilisi	273,000	213,000	156,000	152,834	154,997	188,360	205,274	226,127	-4.6%	1.6%
Yekaterinburg	143,000	148,000	106,000	82,344	89,000	98,805	108,742	169,641	-4.5%	**11.1%**
Yerevan	134,000	100,000	85,000	85,671	97,000	106,039	102,200	142,370	-4.4%	4.8%

	2007	2008	2009	2010	2011	2012	2013	2018	CAGR 2007-13	CAGR 2014-18
Almaty	—	-30%	-35%	-20%	9%	-11%	-14%	10%	-18.1%	7.9%
Astana	—	-32%	-20%	-15%	9%	-9%	21%	11%	-9.2%	11.2%
Average – Russia, the CIS and Georgia	—	-10%	-33%	-4%	8%	-1%	1%	10%	-7.5%	6.4%
Baku	—	-16%	-16%	-2%	-1%	-21%	-8%	9%	-11.3%	3.1%
Kazan	—	9%	-22%	-16%	13%	10%	6%	6%	-0.8%	2.8%
Kiev	—	-12%	-48%	4%	23%	-24%	-8%	9%	-14.0%	5.3%
Moscow Mid-Market/Budget	—	-1%	-30%	-1%	3%	8%	-2%	8%	-4.9%	5.6%
Moscow Upscale/Luxury	—	6%	-38%	8%	9%	4%	-5%	10%	-4.2%	8.4%
Rostov-on-Don	—	6%	-28%	-18%	10%	6%	3%	10%	-4.6%	1.7%
Samara	—	-7%	-39%	4%	7%	4%	10%	12%	-5.4%	4.4%
St Petersburg Mid-Market/Budget	—	-1%	-41%	2%	14%	-1%	4%	10%	-5.7%	9.8%
St Petersburg Upscale/Luxury	—	5%	-44%	4%	6%	2%	12%	13%	-4.8%	8.3%
Tbilisi	—	-22%	-27%	-2%	1%	22%	9%	9%	-4.6%	1.6%
Yekaterinburg	**—**	**3%**	**-28%**	**-22%**	**8%**	**11%**	**10%**	**10%**	**-4.5%**	**11.1%**
Yerevan	—	-25%	-15%	1%	13%	9%	-4%	8%	-4.4%	4.8%

Source: HVS

supply for the last few years. This, coupled with the previously mentioned influx of business, is positively impacting the city's hotel market. It is important to note, that the announced pipeline for the next three to four years includes an increase of almost a 1,000 hotel rooms. However, we forecast that after some pressure on hotel values in the short term, the medium term will see an increase in values in Astana.

Hotels in Kiev and Baku are expected to continue to depreciate in value, owing to the oversupply of hotels, especially in the luxury/upscale segment, coupled with stagnant demand. In Ukraine, the situation is worsened by the economic problems in the country, which are not expected to improve in the short term.

The majority of the reviewed markets are picking up, which is reflected in growth of the region's average value, which increased by 1% compared to the figure in 2012, two percentage points ahead of the European average, once again confirming the fact that the emerging markets of Russia, the CIS and Georgia are recovering slightly faster than the established European markets.

Despite the recent addition to supply and the fact that the market in the city is very seasonal,

CHURCH OF THE SAVIOR ON BLOOD, ST PETERSBURG

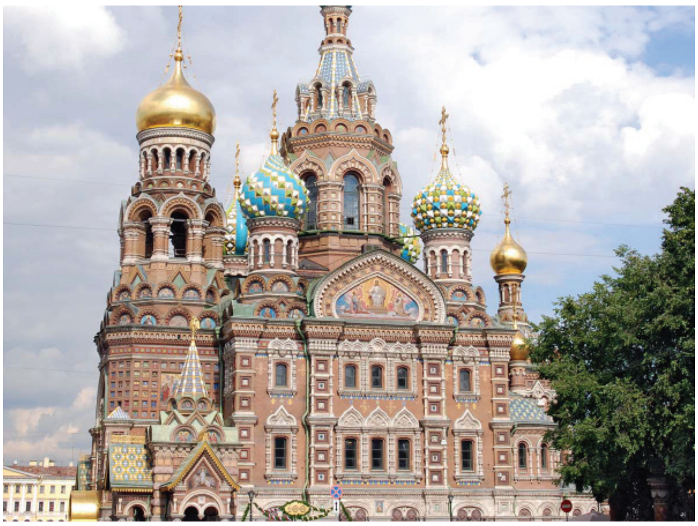


CHART 6: HISTORICAL AND FORECAST VALUES PER ROOM IN LOCAL CURRENCY AND YEAR-ON-YEAR PERCENTAGE CHANGES

	2007	2008	2009	2010	2011	2012	2013	2018	CAGR 2007-13	CAGR 2014-18
Almaty	71,896	49,400	39,900	29,716	33,792	27,735	24,929	33,283	-16.2%	4.9%
Astana	56,588	37,766	37,590	29,721	34,005	28,602	36,345	41,770	-7.1%	0.9%
Baku	359	274	236	214	222	157	145	137	-14.0%	-3.6%
Kazan	4,165	4,745	4,529	3,473	3,997	4,263	4,682	5,626	2.0%	3.1%
Kiev	3,074	4,098	2,192	2,115	2,732	1,923	1,859	2,064	-8.0%	0.4%
Moscow Mid-Market/Budget	10,290	10,661	9,042	8,103	8,484	8,892	9,010	11,230	-2.2%	3.7%
Moscow Upscale/Luxury	17,430	19,241	14,531	14,230	15,747	15,999	15,855	20,985	-1.7%	4.8%
Rostov-on-Don	4,410	4,855	4,262	3,184	3,558	3,685	3,931	3,924	-1.9%	-2.3%
Samara	5,460	5,293	3,907	3,678	3,993	4,027	4,616	5,949	-2.8%	3.6%
St Petersburg Mid-Market/Budget	4,865	5,012	3,614	3,348	3,857	3,731	4,037	5,993	-3.1%	7.8%
St Petersburg Upscale/Luxury	12,530	13,775	9,442	8,937	9,571	9,532	11,032	14,560	-2.1%	3.9%
Tbilisi	699	494	378	353	363	399	447	493	-10.6%	0.2%
Yekaterinburg	5,005	5,402	4,706	3,318	3,640	3,932	4,491	7,006	-1.8%	9.1%
Yerevan	59,067	43,140	45,807	40,505	50,277	54,716	55,305	77,042	-1.1%	5.0%

	2007	2008	2009	2010	2011	2012	2013	2018	CAGR 2007-13	CAGR 2014-18
Almaty	—	-31%	-19%	-26%	14%	-18%	-10%	10%	-16.2%	4.9%
Astana	—	-33%	0%	-21%	14%	-16%	27%	11%	-7.1%	0.9%
Baku	—	-24%	-14%	-9%	4%	-29%	-7%	9%	-14.0%	-3.6%
Kazan	—	14%	-5%	-23%	15%	7%	10%	6%	2.0%	3.1%
Kiev	—	33%	-47%	-4%	29%	-30%	-3%	9%	-8.0%	0.4%
Moscow Mid-Market/Budget	—	4%	-15%	-10%	5%	5%	1%	8%	-2.2%	3.7%
Moscow Upscale/Luxury	—	10%	-24%	-2%	11%	2%	-1%	10%	-1.7%	4.8%
Rostov-on-Don	—	10%	-12%	-25%	12%	4%	7%	10%	-1.9%	-2.3%
Samara	—	-3%	-26%	-6%	9%	1%	15%	12%	-2.8%	3.6%
St Petersburg Mid-Market/Budget	—	3%	-28%	-7%	15%	-3%	8%	10%	-3.1%	7.8%
St Petersburg Upscale/Luxury	—	10%	-31%	-5%	7%	0%	16%	13%	-2.1%	3.9%
Tbilisi	—	-29%	-24%	-6%	3%	10%	12%	9%	-10.6%	0.2%
Yekaterinburg	—	8%	-13%	-29%	10%	8%	14%	10%	-1.8%	9.1%
Yerevan		-27%	6%	-12%	24%	9%	1%	8%	-1.1%	5.0%

Source: HVS

the St Petersburg Upscale/Luxury segment is forecast to grow in 2013 in terms of values per room by 11%, the second highest in the region. As the city is developing and improving its image and attractiveness as a tourist destination in the international market, the demand for quality hotel accommodation is growing. In 2013, we witnessed a slight increase in occupancy in the majority of the hotels across the segment and improved average rate, which caused the growth in hotel values per room. It is worth mentioning that the Four Seasons hotel, which opened in July 2013, has already demonstrated strong performance in terms of average rates, which will marginally push the overall market indicators upwards. Meanwhile, the city's Mid-Market/Budget segment has also been recovering, albeit at a slower rate of 4%. Samara and Yekaterinburg, even though showing double-figure growth in values per room, are still struggling to improve their RevPAR via an increase in average rate, highlighting the fact that even though demand in the regions for quality hotel accommodation is growing, it remains highly price sensitive.

ST SOPHIA CATHEDRAL, KIEV

CHART 7: HOTEL VALUATION INDEX

	2007	2008	2009	2010	2011	2012	2013	**2018**
Almaty	1.577	1.106	0.717	0.573	0.623	0.554	0.476	0.674
Astana	1.242	0.845	0.675	0.573	0.627	0.572	0.694	0.846
Average – Russia, the CIS and Georgia	**1.000**	**0.902**	**0.600**	**0.577**	**0.626**	**0.619**	**0.626**	0.789
Baku	1.102	0.925	0.774	0.755	0.747	0.587	0.538	0.526
Kazan	0.449	0.491	0.385	0.325	0.369	0.404	0.428	0.514
Kiev	1.611	1.419	0.732	0.758	0.930	0.708	0.653	0.733
Moscow Mid-Market/Budget	1.109	1.102	0.769	0.759	0.783	0.843	0.823	1.026
Moscow Upscale/Luxury	1.879	1.989	1.235	1.332	1.453	1.517	1.449	1.917
Rostov-on-Don	0.475	0.502	0.362	0.298	0.328	0.349	0.359	0.359
Samara	0.589	0.547	0.332	0.344	0.368	0.382	0.422	0.544
St Petersburg Mid-Market/Budget	0.525	0.518	0.307	0.314	0.356	0.354	0.369	0.548
St Petersburg Upscale/Luxury	1.351	1.424	0.802	0.837	0.883	0.904	1.008	1.330
Tbilisi	1.030	0.804	0.589	0.577	0.585	0.711	0.775	0.853
Yekaterinburg	0.540	0.558	0.400	0.311	0.336	0.373	0.410	0.640
Yerevan	0.506	0.377	0.321	0.323	0.366	0.400	0.386	0.537

Source: HVS

Growth in Kazan's hotel values was driven by the improved operational performance of the hotels owing to Universiade 2013, hosted by the city in July 2013; however, we expect the growth rate to slow down slightly, which will lead to the city's ranking in Chart 4 dropping from its current 11th place to 15th by 2018.

When looking at the value rankings (Chart 4), the Moscow and St Petersburg Upscale/Luxury segments continue to remain in the top two positions. Astana keeps improving its position, moving from ninth place in 2012 to sixth in 2013.

In the long run, we forecast that in 2018 Yekaterinburg and St Petersburg's Mid-Market/Budget segment will rise a few places, whereas Baku will keep moving down the rankings and thus register a lower average value growth than the other markets in the survey.

Charts 5 and 6 show the average values over the past six years, along with our estimates of 2013 and 2018 values, in both euro and local currency.

Any forecast has an element of uncertainty attached to it. It is important to remember that most of the markets will remain fragile over the next few years and performances in these markets will largely be connected to the speed and magnitude of the new supply as well as the general economic performance. The values presented in the report are market averages and individual hotels might well outperform or underperform the market. At the time of writing this report, the global economy and, in particular, the European financial markets are continuing to be in turmoil. Our projections of future value recovery assume a slow, but steady economic recovery (in line with the GDP forecasts presented in Chart 2). Should the global economy deteriorate significantly, this would have a significant impact on our forecast values per room.

All the countries under review registered an increase in currency exchange rates towards the euro in 2013, showing signs of depreciation. Armenia, Ukraine and Kazakhstan registered the largest drops in local currency value against the euro. Analysing values in local currency is important as it matches the revenue streams that are realised in the national currency with cost structures subject to local inflation levels. In 2013, the falls in average values across the region were far less in local currency as, owing to weakening exchange rates, the fluctuations in the euro were much higher. In 2013, Almaty's average value is forecast to fall by 10% in local currency, but as the Kazakhstan tenge fell by almost 5%, the value decreased in euro terms by 14%. As economies in the region recover from the 2008 crisis, both inflation and exchange rates are gradually returning to more stable levels, and therefore the gap between compound annual growth in euro and local currency terms is now much narrower.

This year, we continue to analyse the index of values across the region to the base of the Russia, CIS and Georgia average in 2007. In 2013, we forecast that both Moscow and St Petersburg's Upscale/Luxury segments will surpass the base (compared to only Moscow in 2012). With Almaty's and Astana's growth projections revised, the only other market we forecast to exceed the base by 2018 is Moscow's Mid-Market/Budget segment. However, Astana and Tbilisi are forecast to get closer to the base, reaching an index of almost 0.9 by 2018.

Looking at the index overall, we can see the effects of the global crisis on the hotel markets in the region and how far the values have dropped. Kiev is currently at about 40% of its index in 2007, while Baku and Astana lost more than 50%. Almaty suffered the most in the region with its index dropping almost threefold.

Volatility

In this publication, we introduce a Volatility Index of the regional hotel values over the past six years (2007-13). The below analysis will allow investors to better understand the overall risks associated with a hotel investment. Hotels are not only a capital-intensive type of asset, but they also might be affected by external factors such as micro- and macroeconomic issues (oversupply, recessions, natural disasters and so forth). All of these factors could have an impact on the profitability of the business; thus, it is critical to be able to quantify the overall level of risk associated with hotel investment. A good indicator of investment risk is volatility, which provides a measure for variation in asset prices over time. Higher volatility implies higher risk. We have therefore included a volatility index, which calculates the standard deviation of the annual capital appreciation/depreciation in value divided by the average value for Russia, the CIS and Georgia as a whole over the same period. For example, Astana has a volatility index of 35%, which means that hotel values are 35% more volatile than the value of a typical hotel in Russia, the CIS and Georgia. A higher level of volatility would be more acceptable in cases where returns are also high. Markets with the highest negative volatility would in fact be the most stable markets, as they would change even less than the average for the region.

KREMLIN, MOSCOW

CHART 8: VOLATILITY INDEX 2007-13

Market	Index
Kiev	66.0%
St Petersburg Upscale/Luxury	40.4%
Astana	**35.0%**
St Petersburg Mid-Market/Budget	29.7%
Samara	26.8%
Tbilisi	26.4%
Moscow Upscale/Luxury	23.6%
Yekaterinburg	21.0%
Almaty	6.8%
Rostov-on-Don	6.4%
Kazan	1.7%
Yerevan	0.7%
Average – Russia, the CIS and Georgia	0.0%
Moscow Mid-Market/Budget	-7.8%
Baku	-43.1%

Source: HVS

Chart 8 shows shows the volatility index for the reviewed markets over seven years (2007-13) in euro terms. As shown in the chart, the only two markets that are more stable than average are Baku and Moscow's Mid-Market/Budget segment. However, looking at this indicator one should not mistakenly assume that the Baku market is the best option for hotel investment, as analysing the numbers further we can see from the above tables that such stability comes from the fact that the values in Baku have been steadily declining over the past seven years.

The rest of the markets are more volatile than the average value across the region, with eight markets in the volatility index exceeding 20% and only four markets being close to average. By comparison, out of the 32 European markets that are analysed in our European HVI publication, only five markets have been more than 23% volatile than average. Such a comparison and the figures shown in Chart 8 further confirm the fact that the hotel markets in the region are not yet mature and are at an early stage of development. We can also further draw from this that the region's hotel markets, despite offering higher returns, are also more risky. More so than with other markets, investors should understand the importance of long-term investments in this region.

The volatility index is a useful tool that puts the performance of hotels in described markets into perspective, and it will be interesting to see how the volatility index changes as the hotel markets in Russia, the CIS and Georgia evolve and mature.

Outlook

Hotel performance in most of the covered markets remains under pressure; however, there are still signs of improvement. In 2012, ten of the 14 markets registered a rise in value. However, as 2013 progressed many of the markets showed signs of continuing pressure on average rates, resulting in only eight markets growing in value. Despite the forecast dip in values, we do not see this as an ongoing trend, but rather a short-term shift.

The timeline for hotel development continues to be lengthy and many of the projects' opening dates have been delayed. Much of this is continuously blamed on the lengthy bureaucratic approval process; however, construction timelines, securing financing and lack of professional project management are also significant contributing factors. As we see more hotels opening in the mid-market and budget segments, the impact on development timeline should be positive. More standardised and generic products do not have lengthy architectural and design components and benefit from easier to obtain fit-out materials.

A recent trend has been the development of franchise hotels. The market is waiting for new products from Hampton by Hilton and Holiday Inn Express, which will be operated under franchise agreements. As local markets continue to develop, we forecast that more hotel brands would be willing to develop franchises, thus increasing the pace of their development. Development of the franchise model is also a sign that local operating companies and owners are becoming more experienced and sophisticated.

In the past two to three years, hotel markets in the region have witnessed more and more investors become willing to develop hotel portfolios; in general, such deals are signed with international brands using the franchise system.

After a very active year of hotel transactions in 2012, we saw a slowdown in 2013. The most high-profile transaction was the sale of the Renaissance Hotel Olympic in Moscow.

Despite the current dip in values, we expect all the covered hotel markets to improve and exhibit positive growth in the medium term. A lot of the announced supply has been corrected and, whilst some markets will feel the effects of oversupply in the short term, general improvements in the economic climate in the region will allow hotels to improve their performances.

MAIDAN NEZALEZHNOSTI, KIEV

We continue to see the shift in development from luxury and upscale properties to the mid-market and budget hotels. This shift is a result of two components. Hotel markets in the region (aside from a few exceptions) cannot support high rates, making luxury and upscale hotels a more risky investment. This is coupled with the fact that development based solely on the ego of the owner is almost extinct. Owners and investors have become more professional and conduct their due diligence more thoroughly prior to investing in a hotel.

New 'ego' projects of hotel investors in the region are focused on building the business image of the owner. Being an owner of the hotel that is operated under a renowned international brand helps to improve the credibility of the investor in the eyes of potential creditors, partners and international business as a whole. Thus, the price segment, trendiness, finishing and location of the hotel becomes irrelevant, as the major point that matters is the running of a successful, transparent hotel business done in collaboration with an international, recognisable hotel company.

As hotel markets develop, we should be better able to distinguish between market segments, thus reporting value not for the whole market, but rather by segments (as we currently do for Moscow and St Petersburg). This will allow investors to get a clearer picture of what is happening in the market. At the moment, the opening of new hotels in, for example, the budget segment can lower the marketwide average rates, simply because there are now more hotels in the market in the lower price bracket. This can at times create the illusion of a worsening market performance, while the reality can be quite different.

Conclusion

We consider that the hotel industry in Russia, the CIS and Georgia will continue to offer investors a lot of potential for returns on their investment. Short-term pressure on some of the markets may result in readjustments of hotel values, but should not deter investors from looking into the future. New supply can also cause some additional short-term pressures; however, many projects get delayed, thus allowing the market to adjust and not crash due to immediate oversupply. Increases in the development of budget hotels allow for greater choice of investment for potential owners.

Even though the region attracts a certain type of investor, attaining professional feasibility studies and diligent cost management, coupled with a solid product and management, will assure returns exceeding those that can be expected in more mature markets.

Understanding the HVI

The Hotel Valuation Index (HVI) is a valuation benchmark developed by HVS. It presents historical and anticipated value trends across 14 markets in Russia, the CIS and Georgia. The methodology adopted to derive these values is based on actual operating data which is maintained by HVS.

The valuation process starts by analysing the supply and demand dynamics in a given market. To quantify demand, actual operating data is used to determine the total accommodated demand, which is essentially the total annual room nights occupied within a defined market, and is supplemented with special events or hotel openings inducing additional demand.

On the supply side, the expected supply pipeline for the defined market is quantified by interviews with hotel operators and developers. The overall marketwide occupancy is then calculated based upon the total projected room night demand and the supply of existing and proposed hotel rooms for the defined period.

Having determined the marketwide occupancy, we then forecast the average rate for the defined market. Various market-specific factors influence the growth rates applied to the average rate, such as the overall status of the economy and the supply-demand equation for the defined period. The marketwide occupancy and average rate is applied to a typical 200-room hotel, thus attaining gross rooms revenue. Other revenue line items are then estimated using individual forecast models. Once the total revenues are derived, individual departmental expenses, undistributed operating expenses and fixed expenses are estimated based on HVS's knowledge of actual operating profiles, thus arriving at the Net Operating Income (NOI). As the HVI uses an income capitalisation approach to derive values, the NOI serves as the basis for determining the value of a typical 200-room hotel in the defined market.

From our experience of hotel financing and conducting several valuations over the past few years in Russia, the CIS and Georgia, HVS established appropriate valuation parameters for each city covered by the HVI. We should note that the capitalisation rates used in the forecast represent an all-in yield, reflecting investor sentiments in both the short and long term as well as availability of debt. The capitalisation rates between 2010 and 2012 were fairly stable, ranging from 9-11%. This level of stagnation in the capitalisation rates can be partly attributed to the continuing recovery process in the markets and scarcity of debt. These market-specific valuation and capitalisation parameters were then applied to the NOI derived for the hotels in each market to arrive at the values per room.

Disclaimer: We note that the valuations presented in this report represent the typical performance of a hotel in each market. Actual valuations of specific hotel assets will vary based on factors such as location, size, brand affiliation, age, condition and actual performance. We specifically note that our values are only based on market information available as of October 2013, and that any significant changes in supply or demand trends beyond this date could have an impact on value. The valuation parameters that were used to arrive at these values were based on our conversations with active hotel investors and reflect current investor sentiments. Any changes in such investor expectations in the future will have an impact on future values.

For further information on the HVI, please contact Alexey Korobkin at akorobkin@hvs.com.

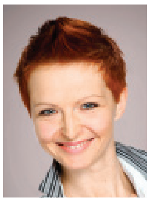
About HVS

HVS is the world's leading consulting and services organization focused on the hotel, mixed-use, shared ownership, gaming, and leisure industries. Established in 1980, the company performs 4500+ assignments each year for hotel and real estate owners, operators, and developers worldwide. HVS principals are regarded as the leading experts in their respective regions of the globe. Through a network of more than 30 offices and 450 professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. www.hvs.com.

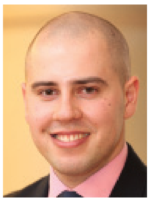
With offices in London since 1990 and Moscow since 2007, HVS serves clients with interests in the UK; Europe, the Middle East and Africa (EMEA); Russia; and the CIS. We have appraised almost 4,000 hotels or projects in 50 countries in all major markets within the EMEA region for leading hotel companies, hotel owners and developers, investment groups and banks. Known as one of the foremost providers of hotel valuations and feasibility studies, and for our ability, experience and relationships throughout Europe, HVS is on the valuation panels of numerous top international banks which finance hotels and portfolios.

Superior Results through Unrivalled Hospitality Intelligence. *Everywhere.*

About the Authors



Tatiana Veller is the Managing Director of HVS in Russia, delivering various types of strategic consulting for all facets of the hospitality industry in Russia, Georgia, the CIS and the Baltics. In addition to Tatiana's HR Consulting background with leading firms in the USA, she possesses extensive operations experience with top companies in the hospitality and food service industries in Russia and the USA, along with a Bachelor's degree in Hotel and Restaurant Management from the Russian Academy of Economics n.a. Plekhanov and a US MBA in International Management. This gives Tatiana a unique understanding of the industry and the strategies that drive performance.



Alexey Korobkin is the associate director of HVS Consulting & Valuation in Moscow, Russia. Following his degree in Economics and Finance, Alexey obtained an MBA in Hotel and Tourism Management from one of Switzerland's top hotel universities. Alexey held positions in various hotels across Europe, the USA and Russia prior to joining HVS in 2010. Alexey specialises in strategic consulting, valuations and investment advisory and completed numerous assignments across Russia, the CIS, Georgia and the Baltic region. Alexey is a regular speaker at major hospitality events in the region as well as an author of numerous hospitality publications.

Margarita Lobova started her career path in hospitality by earning a Degree in Economics and Management in Tourism. At the same time, she joined the Petro Palace Hotel in St Petersburg as a receptionist, gaining knowledge of the industry from an operational perspective. She furthered her experience by doing postgraduate studies in Switzerland at Glion Institute of Higher Education. After graduating from GIHE with distinction, she joined Shangri-La Hotels & Resorts in Abu Dhabi, UAE where she stayed for three years, advancing from Front Office associate to Business Development Manager. In July 2012, Margarita joined HVS Consulting & Valuation Moscow in the role of Junior Consultant.

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HVS Moscow Office | Gilyarovskogo Street 4/5, Office 301, Moscow 129090, Russia

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