2005

Rio de Janeiro

Market Overview

Guilherme Cesari

HVS INTERNATIONAL SÃO PAULO
Av. Brig. Faria Lima, 1912 – Conj. 7F
01452-000 São Paulo – SP, Brasil
+55 11 3093-2743
+55 11 3093-2783 (Fax)

Excellence in Hospitality Consulting and Services Worldwide

May, 2005

Rio de Janeiro
Market Overview

INTRODUCTION

The city of Rio de Janeiro is the second largest city in Brazil with a little over 6 million inhabitants. Producing almost 5% of the GNP, the economy of Rio de Janeiro is second only to that of the city of São Paulo.

The city's two airports – Antônio Carlos Jobim and Santos Dumont – are, respectively the 3rd and 4th busiest in Brazil, registering together over 10 million passengers a year.

Due to her exuberant scenery and rich history, the city of Rio de Janeiro is the port of entry for most every foreign tourist that visits the country and also is the primary economic destination for business and conventions.

As a result of her prominence as a national economic potential and international tourist destination, Rio's hospitality sector developed an extremely diversified room supply: from economic hotels with limited services to very sophisticated luxury properties, operated by anywhere from competent Brazilian companies to some of the most important international chains like Accor, Inter-Continental, Marriott, Le Meridien, Meliá, Orient Express, StarWood, Posadas, Pestana, among others.

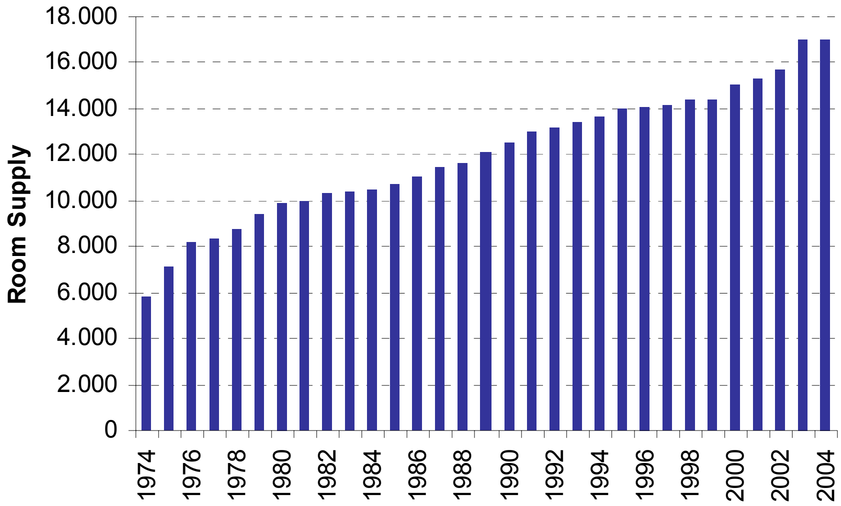
The objective of this document is initially to present some of the general characteristics of the hotel supply in the city and, thereafter, analyze the evolution of the performance of the five star, luxury hotels or those that compete in the top end of the price scale.

THE HOSPITALITY INDUSTRY IN RIO DE JANEIRO

As of December 2004, the city of Rio de Janeiro had a total of approximately 17 thousand rooms distributed among 150 classified hotels[1]. The existing room supply has been evolving over the last 80 years, starting with the Hotel Gloria, inaugurated in 1922. These hotels first began developing in the central region of the city, followed by the Botofogo and Flamengo waterfronts and finally the southern regions of Copacabana and Ipanema beaches and surrounding areas. The first big wave of development occurred at the end of the 40's, spurred by the World Cup competition, which took place in Rio de Janeiro in 1950. In the suceeding twenty years, the room supply doubled. The second major hotel development boom occurred in the second half of the 70's, predominantly on Copacabana Beach in the southern sector of the city. The following graph shows the evolution of the room supply from 1974 through 2004.

[1] Excluded in the room supply are motels, youth hostels, boarding houses, small family run hotels and residential condominiums with monthly rental contracts.

Figure 1 Expansion of room supply since 1974



Source: HVS International

During the last 30 years, the room supply has almost tripled with the average growth reaching 3.7% per year. However, during this period the average annual growth rate has been decreasing, as can be seen below:

- 75 – 84: 6.1%;
- 85 – 94: 2.7%;
- 95 – 04: 2.2%.

The size of new hotels has also diminished. The average number of rooms per hotel, which in 1974 was 162, is now 123.

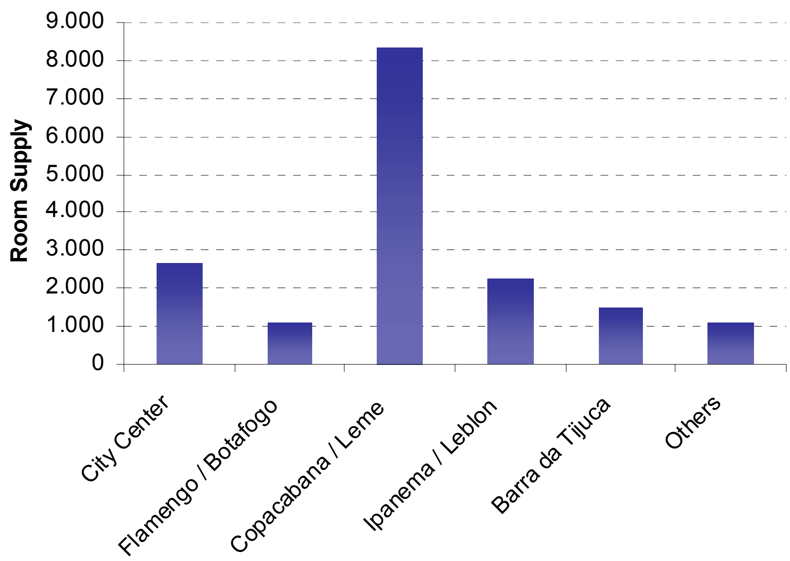
Located on Copacabana Beach, the famous Copacabana Palace Hotel was opened in 1923. The property was a major factor in stimulating urban growth in the south sector of the city, largely in the 1940's, when other important hotels were inaugurated.

It was only in the 70's that major hotels began to be built on the Leblon and Ipanema beaches. It was during this period that the Sheraton Hotel (in Vidigal), the Hotel Nacional and The InterContinental Hotel (both in São Conrado) were inaugurated, and the western regions of the city began to develop hotel properties, signaling the first expansion outside of the Copacabana-Ipanema axis. Opened in 1972, the Hotel Nacional, with 510 rooms, was considered, at that time, to be the largest and most sophisticated hotel in South America. It has, unfortunately, been closed for the last ten years and probably will not be opened in the foreseeable future.

In the Barra da Tijuca neighborhood, the first major hotels were opened in the 80's. More recently, within the last three years, the first internationally affiliated properties have been inaugurated. This signals the beginning of a new third wave of hotel development, this one positioned, for the most part, to attract the business segments of the market.

The figure below demonstrates the distribution of rooms in the key sectors of Rio de Janeiro.

Figure 2 Distribution of the room supply per region

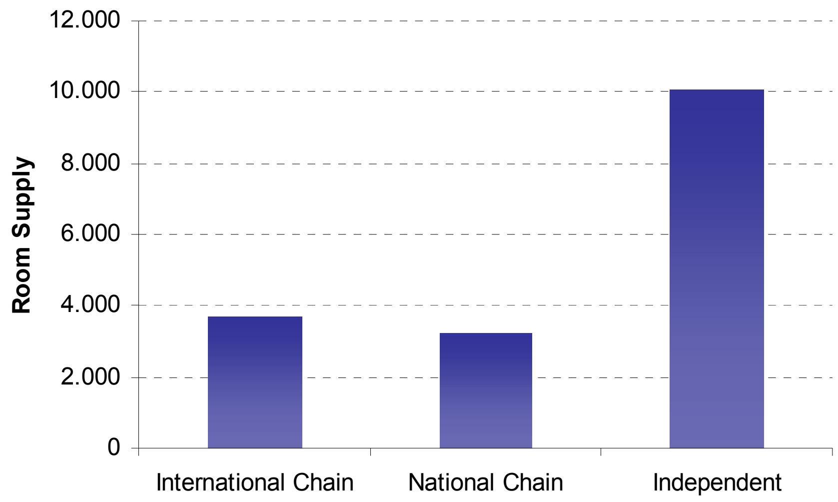


Source: HVS International

Presently, almost half of the city room supply is concentrated in the Copacabana/Leme area. This is distantly followed by the center city with 16%, the Ipanema/Leblon neighborhoods with 13%, and the Barra da Tijuca region with 9%. The Barra da Tijuca, through recent inaugurations, has passed the Flamengo/ Botafogo area in total room supply, and there is a tendency that this area will continue to grow more rapidly that the other regions.

The five star or luxury properties are concentrated in the hands of the international chains. Almost all of the other properties operating in inferior pricing ranges are affiliated with Brazilian chains or are independent. As demonstrated in the following graph, approximately 59% of the hotels in Rio de Janeiro are independent, or without affiliation with any national or international hotel chain. Of the remaining properties, 22% area associated with international companies and 19% with Brazilian operators.

Figure 3 Room supply distribution in relation to chain affiliation



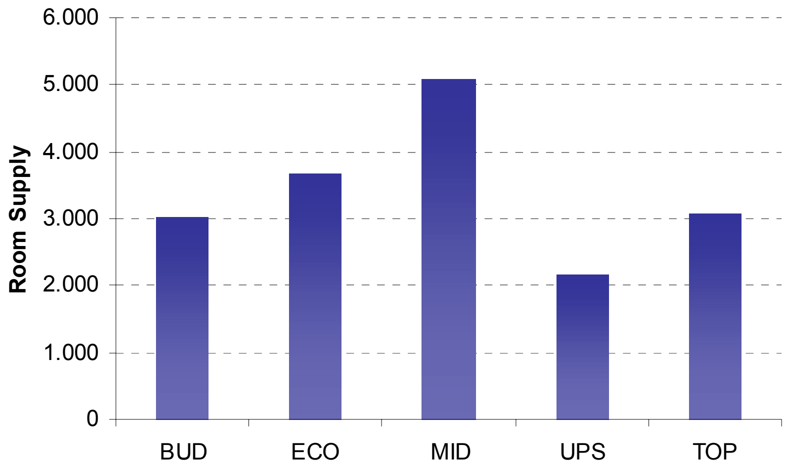
Source: HVS International

The room supply in Rio de Janeiro is quite diversified in terms of quality or luxury standards. To better understand how the room supply is distributed within these standards, the hotels were classified according to their estimated average room rates:

- TOP – more than US$ 100
- UPS (upscale) – from US$ 75 to US$ 100
- MID (midscale) – from US$ 50 to US$ 75
- ECO (economy) – from US$ 30 to US$ 50
- BUD (budget) – less than US$ 30

Figure 4 demonstrates the distribution of the room supply according to the aforementioned quality standards. At present, the room supply allocated in the TOP segment represents 18% of the total supply. The UPS segment is only 13% of the market. The MID segment, as is common in the majority of major Brazilian cities, is the largest segment representing 30% of the total. The bottom two segments, which operate in the largest demand segments, have individually less rooms than that of the MID segment. This leads us to believe that a significant part of the demand for these properties is captured by a large number of small family properties or by other types of hospitality properties like youth hostels and boarding houses.

Figure 4 Room supply distribution by category



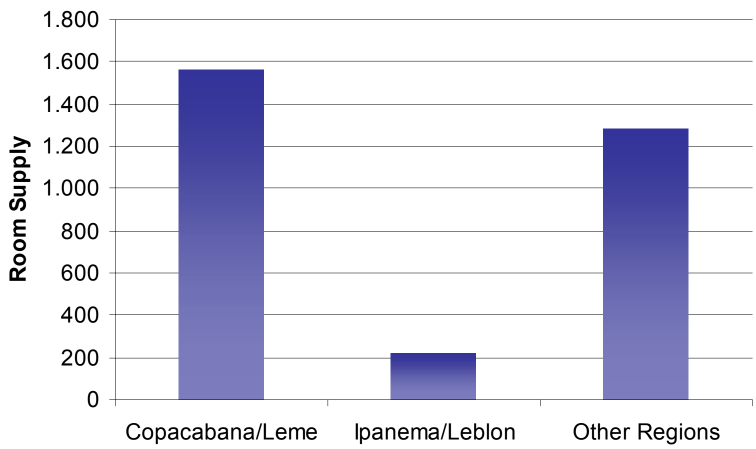
Source: HVS International

Even though there is sufficient demand to permit relatively high average occupancies in all supply categories, we have observed that the TOP segment seems to be more sensitive to brusque occupancy fluctuations when the market is depressed. This occurs because of the elevated supply of rooms in this segment and the consequent higher level of competition among these hotels.

THE "TOP" HOTELS OF RIO DE JANEIRO

The group of hotels in the TOP category is formed by nine properties that total 3.071 rooms, distributed in the following manner throughout the city:

Figure 5 Room supply distribution among the hotels in the TOP category



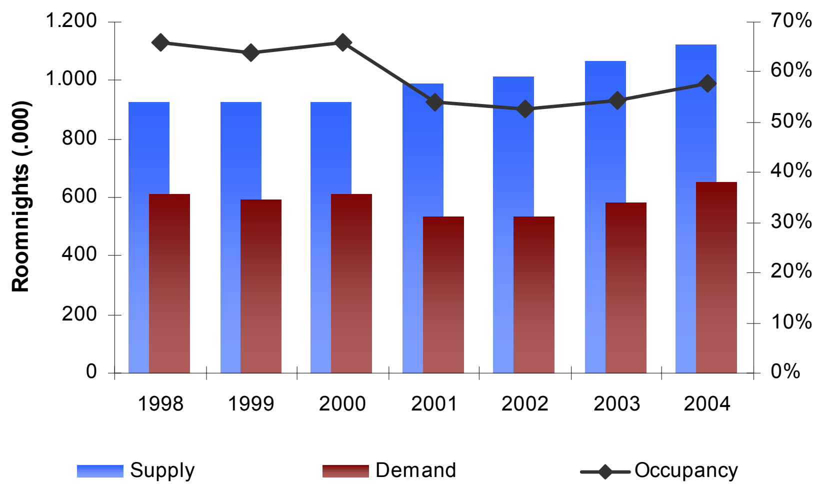
Source: HVS International

The Copacabana area (51%) still predominates as the prime address for the city's most sophisticated hotels. The Ipanema/Leblon neighborhoods are clearly lacking in hotels of the TOP category, even though they are some of the most elegant parts of the city and very attractive to tourists. Other individual regions (Barra da Tijuca, São Conrado and Vidigal) total a significant portion to the TOP category room supply. All the properties in the TOP category are affiliated with international hotel companies.

Description of the annual performance for hotels in the TOP category

The following graphic reveals the evolution of supply, demand and average occupancy rates for the hotels in the TOP category in Rio de Janeiro.

Figure 6 Evolution of supply, demand and average occupancy rates in the TOP category



Source: HVS International

Room supply

During the period of this analysis (1998 – 2004), the room supply rose twice: in 2001 with the opening of the Marriott Copacabana and in 2004 with the inauguration Sheraton Barra da Tijuca. The entrance of these two properties caused the room supply to grow cumulatively 21.5% or an average of 3.3% annually.

Room demand

Between 1998 and 2000, the room demand remained at a high level (roughly 600 thousand roomnights per year), which was largely a result of:

- The privatization processes of government companies (public utilities and such) that have headquarters in the city of Rio de Janeiro;
- The increase in industrial activities related to the petrochemical sector.

In 2001, demand for rooms dropped sharply (almost 13%) and remained at that level, approximately 535 thousand room nights, throughout 2002. A combination of diverse factors keyed the sharp decline in demand:

- A reduction in the number of privatization processes of government companies;
- An international economic recession, spearheaded by the Argentine crisis;
- Internal economic crisises, intensified by the energy crisis;
- International terrorist attacks, which drastically reduced the travel throughout the world and accelerated the crisis within the airline sector, both nationally and internationally.

In 2003, however, demand for rooms reversed its decline (8.4%), and even intensified this growth trend in 2004 with an increase of 11. 9% over the previous year. This upsurge can not be contributed to any single, specific factor but as a result of the growth of the country's economy and to the revival of the international economy.

Average Occupancy Rate

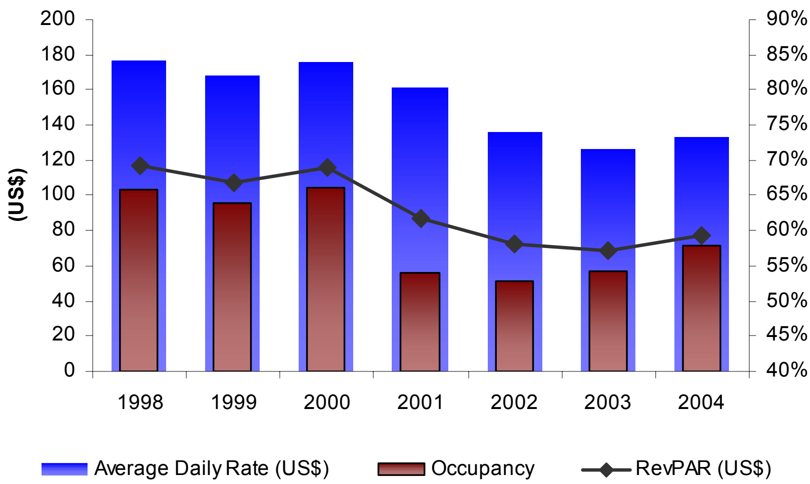
The average occupancy at the beginning of the period of this analysis (1998-2000) was relatively stable at 65%. Between 2001 and 2003, this rate fell abruptly to levels below 55%. With the recuperation of demand, room occupancy rose to 58% in 2004. In spite of the drop in demand and the growth of room supply, the average rooms occupancy never fell below the 50% mark, which demonstrates the remarkable strength of the hospitality market in Rio de Janeiro. This market stamina is a result of two key factors:

- Rio de Janeiro is a complete tourist destination that attracts diverse segments of the market;
- There are formidable barriers for the entrance of new hotel properties.

Rio de Janeiro is a complete destination in that, in addition to being the second largest financial center in Brazil, she is a city of world renown tourist attractions. The barriers against the entrance of new hotels are basically following: the lack of adequate sites to develop new properties; and municipal legislation that inhibits the proliferation of the so-called flat-hotels, hospitality ventures developed by real estate speculators.

Despite the fortitude of the hospitality market and the recent recovery in 2004, the average performance of the hotels suffered a composite decline in 2001, as demonstrated by the following graph.

Figure 7 The evolution of Occupation, Average Daily Rates and RevPAR (US$) for the TOP segment – monetary values for December 2004



Source: HVS International

Average Daily Rates (ADR)

Between 1998 and 2000, the average daily room rates remained above the US$ 170 mark (US$ - Dec/2004); however, in 2001, the ADR began to deteriorate. With the devaluation of the Real and the sharp drop in occupancies, the ADR declined constantly until 2003 when it reached US$ 127. As a consequence of the occupancy upturn in 2003, the ADR began to show signs of recuperation in 2004, reaching a value of US$ 133 (increase of 5.2%). In spite of this slight recovery, the ADR for 2004 still remained 24.7% below previous highs attained in 1998, an average drop of 2.2% per annum during the period of this study. This decline is, for the most part, a result of the devaluation of the local currency (Real).

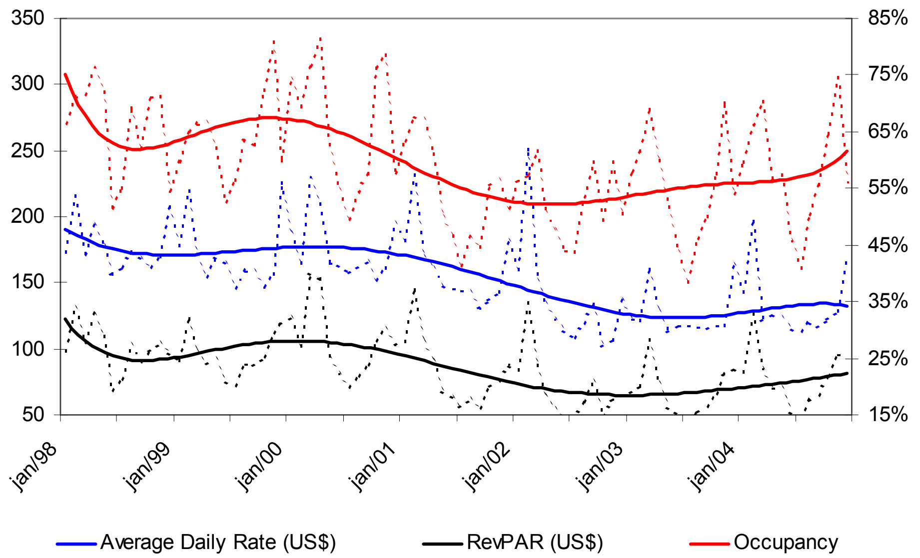
Rooms Revenue

After having reached almost US$ 108 million (US$ - Dec/2004) in 1998, total rooms revenue declined to register an equivalent of US$ 87 million by 2004. Because of the increase in room supply during this period, the Revenue per Available Room (RevPAR) digressed even further, accumulating a 33.9% slump during the period between 1998 and 2004. However, 2004 demonstrated a strong tendency for recuperation as total rooms revenue increased 17.7% in relation to 2003. With the inauguration of the Sheraton Barra in 2004 and the increase in room supply, RevPAR showed an inferior growth in unitary values of only 11.9% in relation to 2003.

Description of the monthly performance for hotels in the TOP category

The following figure shows the evolution of monthly performance for hotels in the TOP category in the city of Rio de Janeiro.

Figure 8 Evolution of the monthly performance for hotels in the TOP price tier



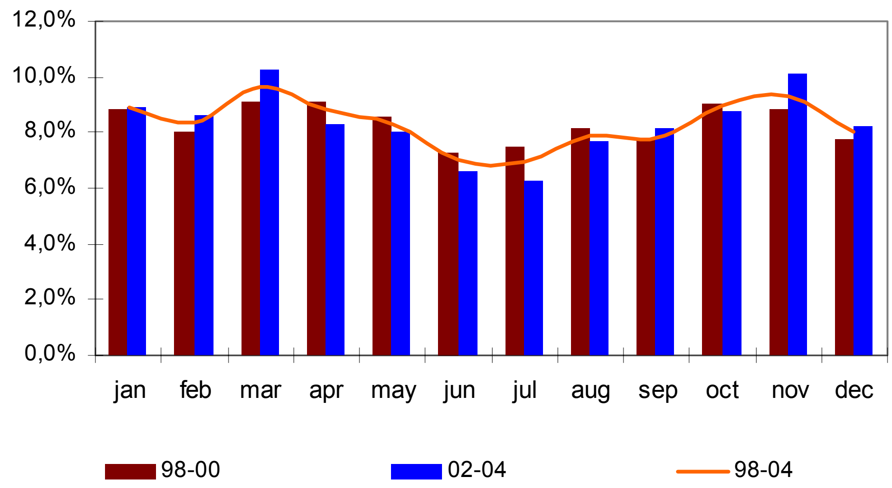
Source: HVS International

In analyzing the graph above, one can observe a reaction delay of about one year between the average occupancy and the ADR. This phenomenon occurs largely as a result of the lingering effect of prenegociated rate agreements with tourism operators and because of the natural delay of the adjustment of room rates resulting from a variation in demand.

When analyzing the period of this study, one can observe a period of four years between the two inferior inflection points on the RevPAR curve and a tendency for growth during the years 2003 and 2004.

The following graph demonstrates the demand seasonality for hotels in the TOP category in Rio de Janeiro for the interval between 1998 and 2004. It also compares the seasonal variations between two distinct periods: 1998 through 2000 and 2002 through 2004.

Figure 9 Seasonal variations for hotels in the TOP category



Source: HVS International

The distribution of the room demand during the year demonstrates the importance of the business and convention segments. The spikes in demand occur during the months characterized by a greater concentration of visitors who participate in events or work related meetings.

Generally, room sales peak in March and November when a heavy concentration of demand from the three principle segments occurs simultaneously: business, convention and leisure. During these months, anticipating and succeeding the tradition vacation period, the hot, summer climate attracts many leisure tourists. At the same time, they are months in which the work related travel intensifies and many of the major events occur.

January, April and October are also months that demonstrate above average occupancy. The elevated room demand of January shows the city's strength in the leisure segment and Rio's potential as a tourist destination. In cities without the leisure appeal and that depend almost exclusively on the business segment for room demand, January is always the month with the lowest average occupancy.

The worst months for hospitality in Rio de Janeiro are June and July, when the climate is not attractive (cloudy and cold) and the July school holidays reduces the level of business travel.

One also can see, in the previous graph, a significant difference in the distribution of demand between the three-year periods of 98-00 and 02-04. The first period (98-00) demonstrates a lesser concentration of demand during the vacation and summer months and a greater intensity during the typically business months. This would indicate the strong influence that the privatization processes and the petrochemical sector had on hotel performance.

AN ANALYSIS OF THE SEGMENTS OF DEMAND

Historically, Rio de Janeiro is a multifaceted tourist destination that attracts diversified segments of the demand for rooms. For this reason, the flow of hotel guests does not display substantial variations during the year. Seasonal variations are small, which offers conditions in which hotels can generate high annual average occupancies.

The principle segments for room demand – business, leisure and conventions – exist for all hotels considered in this study. Of these market segments, however, the convention segment is not exploited to its full potential, due to the lack of an adequate, central convention and exposition center. The only large convention center in Rio is the Riocentro, located at the far end of the Barra da Tijuca, distant from the major hotels, leisure attractions and airports. A majority of the hotels, for their part, do not have adequate convention space, primarily due to their vertical nature and small building sites. For many years, the city has been studying the development of a new convention and exhibition center to be located in the southern or central regions of Rio. The completion of this project would greatly facilitate the attraction of large and mega events and, consequently, would greatly help the commercial performance of the hotels located in the nearby areas.

The business segment predominates in all the hotels of this study, both in terms of room nights and revenue. It is also the least price sensitive segment. However, the penetration of the business segment in hotels located in the southern sector is diminishing as companies are slowly moving out to the Barra da Tijuca, seeking larger, more modern commercial spaces.

In practically all of the hotels, the leisure segment is second largest contributor to room sales. Only in a few hotels with large meeting facilities does the convention segment surpass the leisure segment. Because of the general lack of convention space, these hotels have tremendous bargaining power when negotiating with event planners, getting room rates that proximate those of corporate rates, the highest non-rack rate in the market. The leisure segment is the most price sensitive among the three principle segments. Even though the segment represents a significant part of sales (over 30%), the revenue generation capacity and participation is greatly below that of the other segments.

In spite of the lesser importance, the airline crew segment is also one of relevance in the composition of demand in five star hotels. This segment represents approximately 5% of the total market demand and also obtains the lowest room rates in the market.

FUTURE PERPECTIVES

Presently, two hotels are in the development stage in the TOP category. In the final phase of construction is the Hotel Windsor, located on the beach in the Barra da Tijuca region, with 310 rooms and 32,000 ft^2 of convention space. The second property is a 99 room Philip Starck project located in Arpoador. Inauguration is set for the first semester of 2006.

In the luxury hotel segment, there are few sites available for development in the southern area of the city, the area most popular with tourists. The only alternatives for luxury hotel development in this sector would be a total overhaul of an existing property or the demolition of an existing building for the construction of the new hotel. These alternatives restrict the possibility of the growth of room supply in the southern region in the near future.

At present, the central region does not appeal to the development of five star hotels. However, with urban renewal revitalizing the business district, in the future this area could be attractive to small boutique or design hotels, focusing on specific market niches.

The Barra da Tijuca is one of the few regions where good sites can be found for the development of large, luxury hotels that are oriented toward the business segments. There is a significant and increasing business demand, generated by recently constructed office complexes. However, it is important to emphasize that this area is still developing. The hospitality market (supply and demand) should grow progressively in conjunction with the growth of the local economy and the development and occupation of new office complexes that constitute the primary demand generators for hotels in this region. Although the Barra da Tijuca presents a certain attractiveness for investments in hospitality properties, it is important to remember the fragility of tourism in the area, predominated by businesses, and the lack of attraction for the leisure segment.

With the consolidation of the demand growth seen in recent years, the tendency for room sales of hotels in the TOP category will be growth, considering that room supply should only increase 13% during the next three to four years.

Escritórios e Serviços

AUTHORS

Guilherme Cesari
Senior Associate

Gabriel Falcão
Associate

Ivan Amaral
Associate

Ronald Harling
Trainee

SERVICES – HVS

- Valuation Services
- Consulting Services
- Asset Management & Operational Advisory Services
- Tourism Planning
- Timeshare Consulting & Resort Development
- Executive Search & Operational Advisory Services
- Organizational Assessments / Performance Cultures
- Convention, Sports & Entertainment Facilities Consulting
- Food & Beverage Services
- Gaming Services
- HVS Compass Interior Design
- Marketing Communications
- Technology Strategies
- European Hotel Financing
- HVS / The Ference Group: Operational & Management Strategy Development
- HVS Hodges Ward Elliot

South America

HVS São Paulo
Av. Faria Lima1912, cj. 7F
01452-001 São Paulo/SP
Brazil
+55 11 3093-2743

HVS Buenos Aires
San Martin, 640 – 4º floor
1004 – Buenos Aires
Argentina
+54 11 4515-1461

Europe

HVS London
14 Hallan Street
London W1W 6JC
UK
+44 20 7878-7700

HVS Madrid
C/ Capitán Haya, (15 floor)
28020, Madrid
Spain
+34 91 417-6937

Asia

HVS Singapore
100 Beach Road
#32-04 Shaw Towers
189702 – Singapore
+65 6293-4415

HVS Hong Kong
183 Jade Villa
Ngau Liu Chuk Yeung Road
Saikung – China
+852 2791-5868

HVS New Delhi
c-67, Anand Niketan
2nd Floor – New Delhi, ND
110021 - India
+91 11 2410-1005

Australia

HVS Sydney
Suite 101, Level 1
5 Elizabeth Street
Sydney, NSW, 2000
Australia
+612 9233-1125

North America

HVS New York
372 Willis Avenue
Mineola, NY, 11501
USA
+516 248-8828

HVS San Francisco
Suite 620
116 New Montgomery St.
San Francisco, CA, 94105
USA
+3415 896-0868

HVS Boulder
2229 Broadway
Boulder, CO, 80302
USA
+303 443-3933

HVS Vancouver
4235 Prospect Road
N. Vancouver, BC
V7N 3L6 - Canada
+604 988-9743

HVS Toronto
Suite 202
2120 Queen Street East
Toronto, ON, M4E1E2
Canada
+416 686-2260

HVS Miami
Suite 216
8925 SW 148th Street
Miami, FL, 33176
USA
+305 378-0404

HVS Washington DC
Suite 102
1300 Piccard Drive
Rockville, MD, 20850
USA
+240 683-7123

HVS Chicago
Suite 1A
445 West Erie Street
Chicago, IL, 60610
USA
+312 587-9900

HVS Phonix
Suite 620
116 New Montgomery St.
San Francisco, CA, 94105
USA
+3415 896-0868

HVS Weston, CT
262 Lyons Plain Road
Riversbend
Weston, CT, 06883
USA
+203 226-6000

HVS Boston
607 Boylston Street - 4th Floor
Boston, MA, 02116
USA
+617 424-1515

Published by:
HVS International São Paulo
Av. Brig. Faria Lima, 1912 – cj. 7F.
Tel. +55 11 3093-2743 Fax. +55 11 3093-2783

For more information contact:
Guilherme Cesari gcesari@hvsinternational. com
Or visit our site: www. hvsinternational. com