Brazilian Hotel Market Overview

2008 | 2009

Analysis of the main national lodging markets

Rio de Janeiro, São Paulo e Salvador

Dear Friend,

In 2009, HVS completes 10 years in Brazil! It doesn't even seem as though it's been so long since we associated with Steve Rushmore to bring HVS here!

Looking back, we are proud of the many things that we were able to accomplish: the creation of hotel asset management services; the implementation of economy hotels; the tourism management plan for the state of Bahia; the development of the Itacaré Tourism Institute; the studies on tourism real estate projects in the Northeast; the market studies and valuation analyses for some of the most important hotels in the country; and the creation of the Hotel Maxinvest Fund, the first Brazilian investment fund focused on the hotel market, among other achievements.

All of this would not have been possible without you – our clients, friends, and partners – who put your confidence in us, encouraged our initiatives, and had a decisive role in the significant evolution of the Brazilian hotel industry over the past decade.

This tenth anniversary is a perfect opportunity to celebrate and thank all those who, like you, have been with us throughout our history.

The commemoration, which begins with the publication of the Brazilian Hotel Market Overview, will include a series of events throughout 2009. We will also hold the 2nd South American Hotel Investment Conference.

We hope you enjoy this publication and join us in our celebration, because you are a fundamental part of our company.

Our best and grateful wishes!

Diogo Canteras

Managing Director – HVS São Paulo

Introduction

The past ten years have been a period of great transformation for Brazil and for the national hotel industry.

On the economic front, improvements in the control of inflation and public accounts have brought stability and greater acceptance of Brazil among foreign investors. There were important social gains such as increase and better distribution of the national income. The creation of the Ministry of Tourism in 2003 initiated a time of growing professionalism in the management and promotion of touristic activity in the country. Large investments resulted in expanded and better supply, services and transportation infrastructure.

The hotel industry experienced the expansion of international brands and the rise of Brazilian chains. The internet led to major changes in sales and management strategies. The creation of the Forum of Hotel Operators of Brazil (FOHB) meant greater integration. New forms of financing fueled the expansion of the hotel supply, which broadened its geographic reach and diversified with the development of economy hotels, boutique hotels, and resorts. New players appeared, such as real estate investment funds and private equity funds. In a more professionalized environment, the importance of asset managers grew.

These achievements took place in a challenging environment. Some of the troubles faced were caused by factors external to the lodging industry, such as sharp fluctuations in exchange rates, financial crises, and problems with civil aviation. Nevertheless, certain difficulties could have been avoided by better understanding the dynamics of the market; this is the case with oversupply as well as the construction of unfeasible and problematic enterprises.

The current economic and financial crisis closed the most recent business cycle. From now on, the outlook is uncertain and business strategies must be renewed. HVS – which has accompanied the evolution of the Brazilian hotel industry, becoming part of its history – believes that the present moment is appropriate for analyzing the past and for taking a look at the future.

We believe that it is becoming increasingly important to provide, on a regular basis, consistent information and relevant analyses about Brazil's main markets. With this publication, we seek to reaffirm our commitment to watching the lodging industry with strategic sight, anticipating challenges, identifying opportunities, and providing our clients and partners with pertinent and timely solutions.

About this Publication

The Brazil Market Overview is a periodic publication containing data and analyses, provided by HVS, about the main markets in the Brazilian lodging industry.

In this first issue – commemorative of the tenth anniversary of HVS in Brazil – the reader will find a retrospective analysis of Rio de Janeiro, Salvador and São Paulo, as well as the outlook for the coming years.

Our objective is to study and document the evolution of the Brazilian hotel industry so as to better understand its main drivers and to anticipate challenges and opportunities. We also hope to provide a tool that will be useful to hotel managers and investors in the elaboration of their operational, commercial, and investment strategies.

We are open to questions, suggestions, and comments, which will help us to reach this objective.

Please contact us through our website http://pt.hvs.com

Rio de Janeiro

Market Overview

Rio de Janeiro

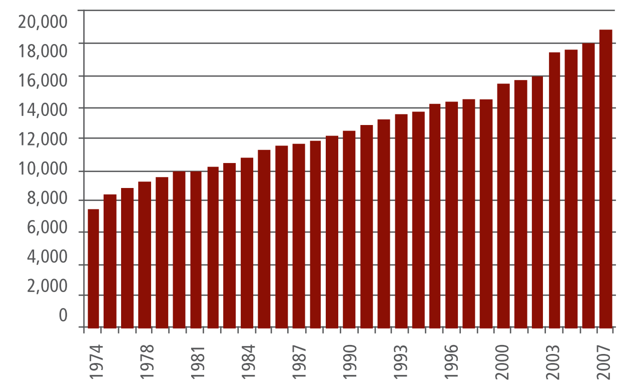
The city of Rio de Janeiro is Brazil's second-largest economy, representing close to 5% of the country's GDP, behind only São Paulo. It is also the second most populous city, with slightly more than 6 million inhabitants. The city's two airports – Antonio Carlos Jobim and Santos Dumont – are, respectively, the third and fourth busiest in Brazil, and together they register an annual passenger volume of over 13 million. Its exuberant natural and historical wealth make Rio the first destination for almost all foreign tourists who visit Brazil for leisure. In addition, it is an important economic center that attracts executives for work and events of various types and sizes.

Because it stands out as a national economic pole and an international tourist destination, the city of Rio de Janeiro has developed a hotel supply that is quite diversified: from economy hotels, with limited services, to the more sophisticated ones, administered by competent national chains as well as by the most important international chains, such as Accor, InterContinental, Marriott, Meliá, Orient Express, Starwood, Posadas, and Pestana, among others.

History of the Hotel Supply

In 2008, there was identified in the city of Rio de Janeiro a total rated hotel supply[1] of about 19,000 available rooms in approximately 150 hotels.

Figure 1 - Evolution of the Supply (rooms)



Source: HVS and Guia 4 Rodas

The hotel supply in place today was developed over the course of the past 80 years, initially in the central region, then on the seafront of Botafogo and Flamengo, next in the southern zone (Copacabana, Ipanema, and environs), and finally in Barra da Tijuca, the principal zone of current expansion. The Glória, inaugurated in 1922, is the oldest hotel in operation and marks the beginning of the development of Rio's hotel supply. The Copacabana Palace, inaugurated in 1923, had the role of stimulating hotel development and urban growth in the southern zone of the city. The first major expansion in the hotel supply took place at the end of the 1940s by virtue of the 1950 World Cup, which was held in Rio de Janeiro.

The second leap in development occurred in the 1970s, when important hotels began to be constructed in Leblon and Ipanema. Also inaugurated during this period were the Sheraton, the Nacional, and the InterContinental (all in São Conrado), starting the movement toward the western region, beyond the Copacabana-Ipanema axis. The Hotel Nacional, with 510 rooms, inaugurated in 1972, was once the largest and most sophisticated hotel in South America, but it has been closed for almost 10 years and there is no plan for it to be reopened.

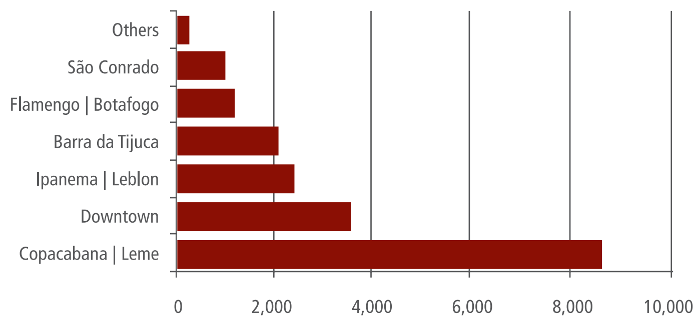
The third impetus was after 2000, with inaugurations in all hotel regions of the city. The majority of the new hotels are operated by hotel chains and target customers in the business, mid-level, and economy segments. During this period even more luxury properties were inaugurated, such as the JW Marriot Copacabana, the Sheraton Barra, and the Fasano Ipanema. The hotel supply of Barra da Tijuca, which grew slowly during the 1980s, expanded rapidly after 2000, stimulated by the growth of the region.

In the past 34 years, the supply has increased by 157% (an average of 2.8% per year). The growth rate was lower in the 1990s, but it accelerated once again in the present decade.

Geographic Distribution

Currently, 46% of the city's rated hotel supply is concentrated in the region of Copacabana/Leme., followed by the city center, with 19%, Ipanema/Leblon, with 13%, and Barra da Tijuca, with 11%.

Figure 2 - Distribution of Hotel Supply by Region (rooms)



Source: HVS

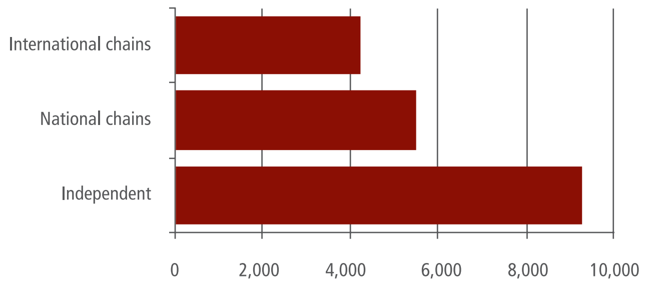
1. This supply excludes motels, hostels, pensions, and serviced residences with predominantly monthly contracts.

The Copacabana/Leme region has lost market share, as a result of limited expansion, due to the lack of available space. The supply in Barra da Tijuca, with its recent inaugurations, surpassed that of Flamengo/Botafogo, and the tendency is for it to expand more rapidly than other regions. The city center has also shown above-average growth in recent years, due to the inauguration of economy hotels. However, it has not shown the same potential for development as Barra da Tijuca.

Affiliation

Close to 49% of Rio's hotels are independent. The remaining ones are associated with international chains (22%) and national chains (29%). As compared with past years, it can be noted that the independent hotels have lost market share to the national operators, while the international chains have maintained their market share. The appearance and strengthening of various small national hotel chains have contributed to this phenomenon.

Figure 3 - Distribution of Hotel Supply by Affiliation (rooms)



Source: HVS

Although the main international chains are present in Rio de Janeiro, they operate hotels essentially in more expensive segments. The majority of the hotels in the intermediate and lower price ranges of the market are national chains or independent.

Segmentation

The demand for Rio's hotels is made up of, in general terms, the business, leisure, and convention segments.

The business segment is predominant, in terms of both demand and revenue, as it is the least sensitive to price. There is a tendency for growth of this segment in Barra da Tijuca due to the introduction of various companies in this region, resulting from the greater availability of modern office buildings. In addition, the recent discovery of new oil wells off the coast of the state should markedly stimulate the business demand in the southern and central zones starting in 2010.

The leisure segment is the second largest among hotel customers, but it is the most sensitive to price. For this reason, its relative importance in terms of revenue is lower than that of other segments.

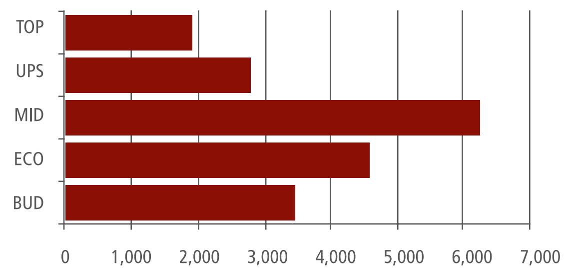
For many years, the only major convention center was the Riocentro, located in Barra da Tijuca, far from the main hotels, attractions and airports. Moreover, most hotels did not have large spaces for meetings and convetions.

As a result, hotels with good convention spaces were able to negotiate elevated room rates with groups. In recent years, two large convention centers have been inaugurated: that of the Windsor Hotel, in Barra da Tijuca, and the Rio Cidade Nova Convention Center, in the central region of the city. This should increase the number of events, though it may negatively affect the segment's room rates.

Rio de Janeiro's hotel supply is quite diversified in terms of standard of quality and sophistication. To show how the supply is distributed among the various categories, the existing hotels were classified according to their estimated average daily room rate:

- TOP – over R$ 360;
- UPS (upscale) – from R$ 271 to R$ 360;
- MID (midscale) – from R$ 141 to R$ 270;
- ECO (economy) – from R$ 90 to R$ 140;
- BUD (budget) – under R$ 90.

Figure 4 - Distribution of Supply by Segment (rooms)



Source: HVS

The TOP segment supply currently represents 11% of the total supply. The UPS segment represents 17%. The MID, as is typical in Brazilian capital cities, has the largest supply, with 29% of the total. The ECO and BUD segments represent 24% and 18%, respectively.

It is important to mention that a significant portion of the demand for lodging in the more economical segments is met by small family-run properties or by other types of lodging, such as pensions and hostels.

Over the course of recent years, Rio de Janeiro's hotels have demonstrated some mobility between market segments. This was mainly the result of hotel renovations, the decline in attractiveness of some locations, and the pressure exerted by exchange rates on room rates.

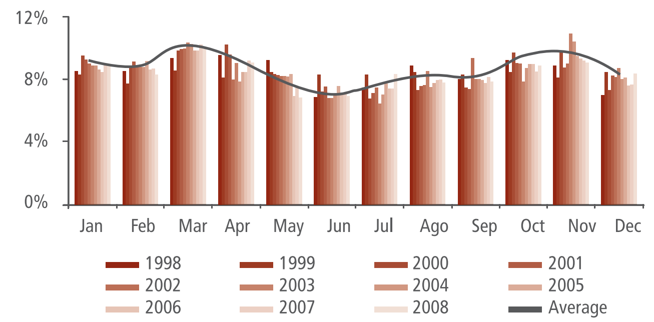
Seasonality

Due to the attractiveness of Rio de Janeiro among the main segments, as well as the strong presence of foreigners and Brazilian travelers, the seasonality of the hotel demand is quite low in comparison with other destinations.

Peak demand occurs in the months of January, February, March, October, and November, when the business, convention, and leisure segments combine to reach significant volume. During these months, vacations and warm weather attract tourists, while at the same time there is an intensification of business activity and large events such as seminars, trade fairs, and expos.

The months of April, May, and December can be considered on par with the average. The months of below-average demand are June, July, August, and September, when the weather is less attractive and there are fewer business meetings and events.

Figure 5 - Seasonality of Demand (% of annual demand)



Source: HVS

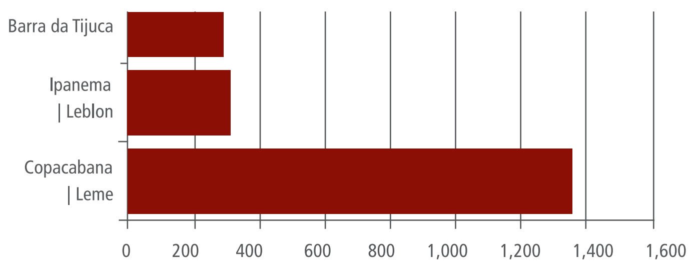
The TOP Hotels of Rio de Janeiro

Some relevant events occurred in Rio's TOP market in recent years. Various hotels (notably the Sofitel, Copacabana Palace, and Caesar Park) invested heavily in the improvement of their infrastructure and accommodations. In addition, with the termination of the contract between Starwood and the Previ pension fund, the former Hotel Le Méridien began to operate as the Iberostar and was closed for renovations for the purpose of meeting the quality standard of the new brand. Due to commercial disputes, the renovations were interrupted, the building remained closed during all of 2008, and there is no projected date for reopening the hotel. Finally, Hotel Glória was purchased in 2008 and is set to be renovated and partially converted into an office building.

Geographic Distribution

Currently, the group of hotels in the TOP category is made up of 7 properties, totaling 1,958 rooms that are distributed in the following manner among the regions of the city:

Figure 6 - Distribution of TOP Hotels by Region (rooms)



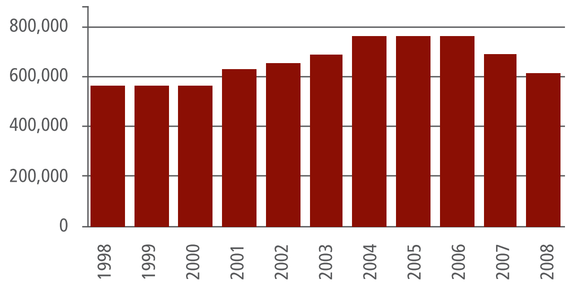
Source: HVS

The Copacabana region is still predominant as the address of the most sophisticated hotels. The Ipanema/Leblon region, historically considered lacking in luxury hotels, had its supply expanded with the arrival of the Fasano, an event that marked the entry of a Brazilian hotel chain into the TOP segment. The Barra da Tijuca region joined the TOP group with the opening of the Sheraton Barra. The São Conrado region, which traditionally had been part of the TOP group, was excluded, as the luxury hotels located there had their daily room rates significantly reduced.

Supply

Between 1998 and 2004, the TOP supply grew by nearly 40% (an average of 6% per year), featuring two leaps: in 2001, with the entry of the JW Marriott Copacabana, and in 2004, with the opening of the Sheraton Barra da Tijuca. In 2007, the inauguration of the Fasano and the closing of the Iberostar (former Le Méridien) for renovation occurred, provoking a variation of -20% from 2007 to 2008. As a result, the accumulated growth between 1998 and 2008 was only 10%.

Figure 7 - Supply of TOP Hotels (room nights)



Source: HVS

Demand[2]

Between 1998 and 2000, the annual demand remained stable. During this period the market was heated up, mainly because of the privatization processes of the state companies with headquarters in Rio de Janeiro and because of the increase in activity in the petrochemical sector.

In 2001, despite the increase in supply, demand fell sharply as a consequence of restrictions in international travel resulting from the terrorist attacks in the U.S., the economic crisis in Argentina, the energy crisis in Brazil, and the reduction of privatizations of state companies.

Between 2002 and 2004 there was an intense increase in demand, set off by the strong dynamism of the world economy, by the drop in average daily room rate in dollars as a result of the devaluation of the Real (which favors the migration of hotel guests from the UPS segments to the TOP segment), and by the induction of demand resulting from the expansion of the supply of TOP establishments. This process was followed by a period of stability that lasted from 2004 to 2006.

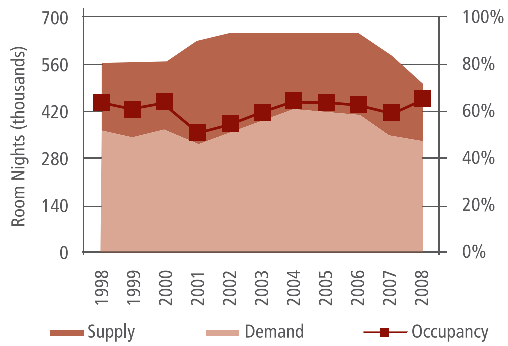
In 2007, the closing of Iberostar's 496 rooms for renovation implied a significant reduction in demand, as with fewer rooms available, part of the demand that had been accommodated by the TOP segment migrated to other hotels (this movement was intensified by the fact that the Iberostar had practiced daily room rates that were among the lowest of the TOP segment). Other important drivers of the drop in demand in 2007 were: the crisis in the Brazilian air transportation system, the increase of the room rates in dollars (which stimulated the migration of hotel guests from the TOP segments to the UPS segment), and the unfavorable exchange rates (which inhibited receptive tourism, reducing the number of foreign tourists). The Pan-American Games had a limited impact on the TOP hotels, due to the concentration of a large part of the activities in Barra da Tijuca and the low propensity of the organizers and spectators to stay at luxury hotels.

In 2008, the closing of the Iberostar and the elevated exchange rate remained the main drivers of the retraction of demand. In addition, a dengue outbreak at the beginning of the year resulted in the cancellation of events and business and leisure trips, and the international financial crisis meant a reduction in foreign corporate hotel guests in the last quarter. On the other hand, Brazil's strong economic growth and the devaluation of the Real in the second semester lessened the drop in demand and caused it to vary less intensely than the supply, resulting in the recovery of occupancy rates.

Average Occupancy

As a result of the variation in supply and demand, the average occupancy of the TOP hotels suffered large oscillations during the period analyzed. Between 1998 and 2000, the average occupancy stayed above 60%, then fell sharply to almost 50% in 2001, and gradually recovered in the following years. The 2000 level was reached again in 2004 and maintained until 2006. In 2007, even with the reduction in supply due to the closing of the Iberostar, there was a slight decrease. In 2008, the occupancy went up again and reached a level of 65%.

Figure 8 - Supply, Demand, and Occupancy of the TOP Market



Source: HVS

2. The market performance analyses include six of the seven properties belonging to the TOP segment and cover all of those located in Copacabana/Leme and Ipanema/Leblon.

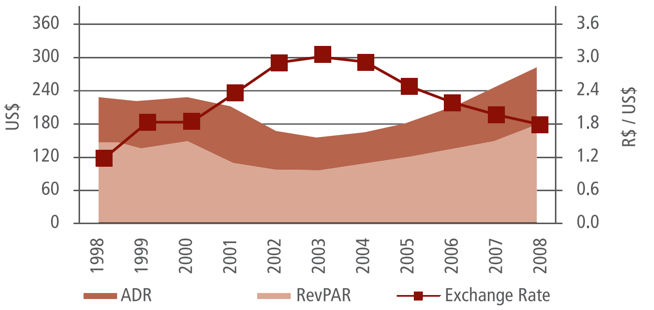
Despite the decrease in demand and the increase in supply, the average occupancy was never below 50%, which shows the strength of Rio de Janeiro's hotel market. This solidity occurs for two reasons: the high touristic attractiveness of the city to seasonally complementary demand segments (leisure, events, and corporate), the existence entry barriers for new hotels (lack of availability of good plots, and legal restrictions on the construction of condo-hotels), and the high level of competition.

Average Daily Room Rate

Measured in **dollars** (December 2008 dollars, adjusted according to the U.S. Consumer Price Index), the average daily room rate of Rio's TOP hotels showed relative stability between 1998 and 2000, oscillating at around US$ 230. Starting in 2001, it decreased gradually until 2003, when it neared US$ 160. This reduction (caused in large part by the currency devaluation) elevated Rio's international competitiveness as a tourist destination, leading to an increase in demand. Starting in 2004, a recovery began that lasted until 2008, when the average daily room rate reached its highest point of the period analyzed, 80% higher than the 2003 value.

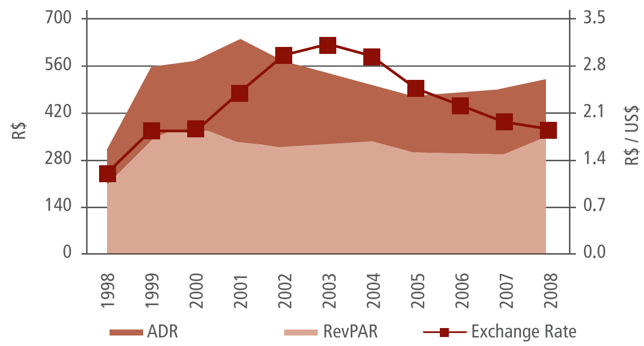
Measured in **Reais** (December 2008 Reais, adjusted according to the Brazilian Consumer Price Index), the average daily room rate started at a level of R$ 300 in 1998, jumped to close to R$ 560 in 1999 due to the devaluation of the Real, and continued rising until 2001, when it reached its highest point of the period analyzed, above R$ 600. Starting then, the room rate began a tendency of decline (in line with the currency value). This tendency reversed in 2006 with a recovery that continued until 2008, when the daily room rate was approximately R$ 500.

Figure 9 - Performance of the TOP Market (prices in 2008 US dollars)



Source: HVS

Figure 10 - Performance of the TOP Market (prices in 2008 Reais)



Source: HVS

Curiously, the recovery of the daily room rate after 2006 occurred during a period of declining occupancy and currency appreciation. This fact is partially due to the inauguration of the Fasano, a hotel with high daily room rates, but it also symbolizes a structural change in Rio's TOP market, as it points to the decoupling of the daily room rate in Reais in relation to the exchange rate. This phenomenon avoided a potentially ominous price war.

Other factors were also important for the decoupling of the daily room rate from the exchange rate. The evolution of reservation systems, internet sales, and other technological advances allowed for faster adjustment of prices in dollars, allowing the exchange rate variations to be passed on to consumers. In addition, the domestic market remained heated during the period in question, and though there was a decrease in occupancy of the TOP hotels, this occurred in part because of the redirectioning of hotel guests from the TOP segment to the UPS segment. Moreover, the decrease in occupancy was compensated by the increase in room rates, maintaining the RevPAR value in Reais, which confirms the success of the pricing strategy.

RevPAR

As a result of the occupancy and room rate dynamics, the RevPAR (revenue per available room) in dollars remained stable between 1998 and 2000, decreased until 2008 and restarted its growth since then, nearing the peak level of the historical period analyzed. During the period, the RevPAR started at approximately US$ 150, then fell close to 40%, nearing US$ 90, and then recovered intensively, reaching US$ 190.

The RevPAR in Reais started at a level of R$ 200, rose to R$ 370 in 2000, remained at around R$ 290-330 between 2001 and 2007, and recovered to R$ 340 in 2008.

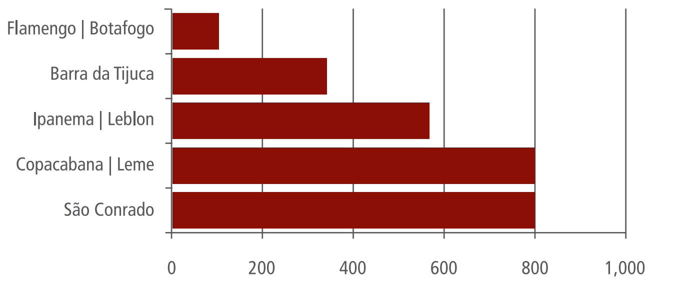
The Upscale Hotels of Rio de Janeiro

The majority of the hotels in the UPS segment currently in existence in Rio de Janeiro were inaugurated before the beginning of the 1980s. Many were hotels of the TOP segment at some period of their existence but lost this status due to the opening of new and more sophisticated hotels, the failure to renovate their structure, or the reduction in the attractiveness of their locations. In general, these hotels are administered by national and international hotel chains.

Geographic Distribution

Currently, the group of hotels in the TOP category is made up of 13 properties, totaling 2,824 rooms that are distributed in the following manner:

Figure 11 - Distribution of Upscale Hotels by Region (rooms)

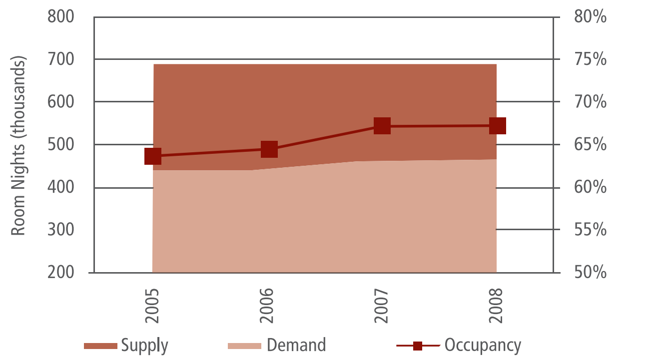


Source: HVS

Supply, Demand, and Average Occupancy[3]

Over the course of the last four years, the supply of the UPS segment has remained stable. The demand has shown an increase, making the occupancy rate go up from 64% to 67%.

Figure 12 - Supply, Demand, and Occupancy of the Upscale Market



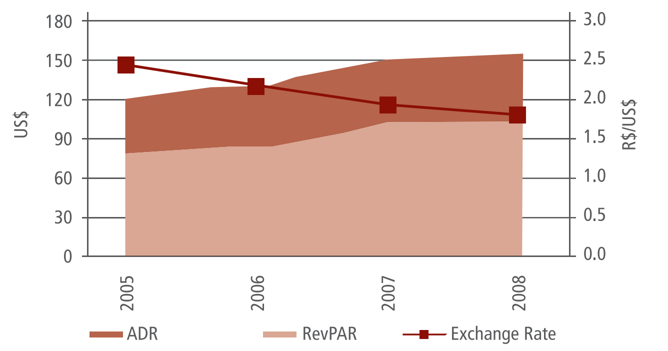
Source: HVS

Average Daily Room Rate and RevPAR

Measured in **dollars** (December 2008 dollars, adjusted according to the U.S. Consumer Price Index), the average daily room rate of the UPS hotels shows an increase of 25% during the period analyzed, varying from approximately US$ 120 to US$ 150. The RevPAR shows similar movement, rising from US$ 79 to US$ 105, with a valuation of 32%.

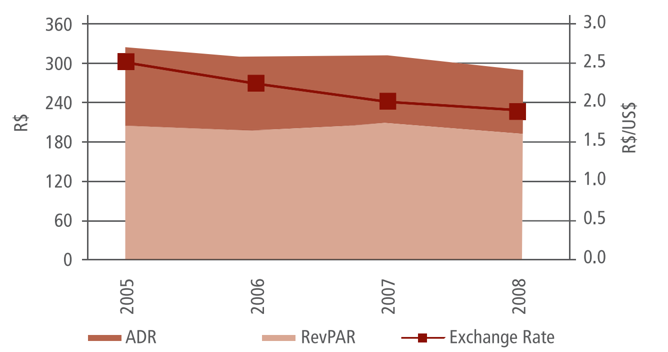
Measured in **Reais** (December 2008 Reais, adjusted according to the Brazilian Consumer Price Index), the average daily room rate shows a retraction of approximately 10% during the period analyzed, falling from R$ 310 to R$ 280. The RevPAR (revenue per available room) shows a less intense retraction (-5%) due to the rise in occupancy. Overall, there is a strong link between the average daily room rates and the exchange rate. However, the appreciation of the Real exceeded the variation in the daily room rate, which suggests that the costs stemming from the variation in the exchange rate were partially passed on to the consumer in the form of room rates.

Figure 13 - Performance of the Upscale Market (prices in 2008 US dollars)



Source: HVS

Figure 14 - Performance of the Upscale Market (prices in 2008 Reais)



Source: HVS

3. The market performance analyses include 8 of the 13 properties belonging to the UPS segment.

Perspectives and Opportunities

There are many doubts and uncertainties in relation to 2009. This year the economy will feel with greater intensity the effects of the international financial crisis, which was aggravated starting in September 2008 and provoked a strong global economic downturn. The forecasts of Boletim Focus (a publication of the Brazilian Central Bank) from the beginning of this year point to a much weaker national economic performance this year than in the previous two years, with only a 2% anticipated growth GDP. Moreover, it is expected that the exchange rate will remain close to R$ 2.30/US$.

In practice, the crisis will have contradictory repercussions on Rio de Janeiro's hotel market. The expectation is that the result will be the maintenance or an increase in the level of revenue, especially for the hotels in the UPS and TOP segments, whose rates have the strongest relation with the value of the dollar. In addition to driving up the average daily room rate in Reais, the elevated exchange rate could stimulate the migration of international hotel guests from the UPS segment to the TOP segment and also drive an increase in domestic demand, especially for leisure travel. Although the depreciation of the Real tends to stimulate the arrival of international visitors, the recession of the global economy could trump this effect and lead to a reduction in foreign hotel guests. The national corporate segment will also likely feel a cooling of economic activity. As a result of all of these changes, the hotels' mix of clients may suffer alterations.

Scarcity of credit tends to provoke delay of new projects and renovations. There is no forecast of a large expansion in supply, and this lack of development should benefit the existing enterprises. In 2009, there is only one hotel opening scheduled (a MID hotel near Santos Dumont Airport). Among other projects about which there is news are: three MID hotels in the southern zone and in the central region, and two UPS hotels in Barra da Tijuca. However, there is no confirmation of the implementation of these enterprises, nor is there a scheduled date for groundbreaking. The renovation of Hotel Glória should cause a reduction in the supply, given that the hotel will remain closed for several months and some of its rooms will be converted to office space.

A similar future may await the Iberostar. There is a good chance that the Iberostar will remain closed for many months, considering that it was put on sale by Previ. The hotel represents an excellent opportunity for investors or hotel chains with a strategic interest in Rio de Janeiro. However, due to its excellent location, there will surely be other parties interested in acquiring the property for other commercial use.

In the coming years, there will remain the traditional difficulties of development in Rio, such as: the absence of available space in the most attractive areas, high land prices as compared to the standard of the hotel market, and legal restrictions on the development of condo-hotels. The region with the greatest availability of land continues to be Barra da Tijuca, but the land prices may make the development of new hotels unfeasible. In this case, an adequate approach is the development of enterprises for mixed use (residential, commercial, and hotel) that are appropriate for the urban context in question.

Given the difficulties in developing new hotels, the main opportunities for expansion and investment seem to be the acquisition of existing properties and the attainment of operational contracts with the numerous independent establishments (especially in the MID, ECO, and BUD segments). In this sense, the central region of the city can present good opportunities, now that it has become more attractive since the construction of the Rio Cidade Nova convention center. For long-term investors with available capital, the economic deceleration expected for the next months may present itself as a good moment for buying.

In a longer-term perspective, the 2014 World Cup, which Brazil will host, should generate investments in infrastructure and publicity in Rio de Janeiro, stimulating the economic activity and hotel demand of the city before, during, and after the event. However, the outlook for growth in the hotel supply is still not clear, as the direct impact of the event on the hotel sector will last, in the best case, for several months, whereas the viability of a hotel depends on many years of cash flow. On the other hand, it is possible that there will be financial and tax incentives that will justify the development of new enterprises and the renovation of the existing ones.

HVS

São Paulo

Market Overview

São Paulo

The city of São Paulo is Brazil's largest economy, representing roughly 15% of the national GDP. It is also Brazil's most populous city, with just over 11 million inhabitants. The city's two airports – Guarulhos and Congonhas – are, respectively, Brazil's first and second busiest airports, and they register a combined volume of more than 34 million passengers per year.

Due to the city's economic importance on the national and international stage, nearly 90% of the travelers who stay in the city's hotels are exclusively focused on business and events, and remain in the city for an average of one or two nights.

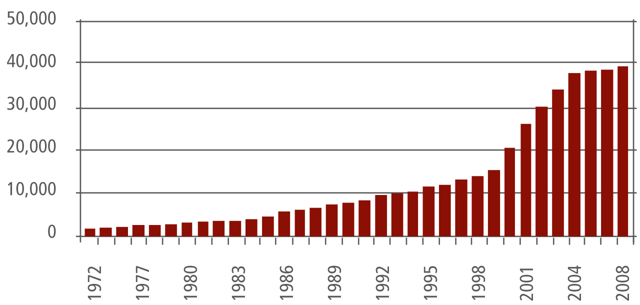
To meet this demand, São Paulo possesses the largest hotel rooms night in the country, including a great variety of products, from economy hotels with limited services to large 5-star hotels and small luxury hotels.

This market has attracted the attention of the major Brazilian and international hotel administration companies, such as Accor, Sol Meliá, Hyatt, Hilton, InterContinental, Marriott, Blue Tree, Transamérica, and Atlantica, among others.

History of the Hotel Supply

In 2008, the total hotel supply was of nearly 39,000 available rooms, in approximately 223 rated hotels[4].

Figure 1 - Evolution of the Supply (rooms)



Source: HVS and Guia 4 Rodas

The hotels currently active were developed over the course of the past 80 years. The first hotels opened in the central region and later hotels were developed toward the western and southern regions of the city. The hotels initially came to the region of Paulista Avenue and Jardins, later spreading out to other regions such as Itaim and Vila Olímpia, Moema and Ibirapuera Avenue, and Berrini Avenue and Chácara Santo Antonio.

The first major expansion of São Paulo's hotel supply occurred in the late 1970s and the early 1980s.

Starting in the second half of the 1990s and continuing until the first half of the 2000s, large 5-star hotels were inaugurated and there was an intense flurry of openings of new condo-hotels (real estate enterprises of dispersed ownership and mixed use as hotel and serviced residence). Between 2000 and 2005, more than 20,000 new rooms were built, more than half of the current supply.

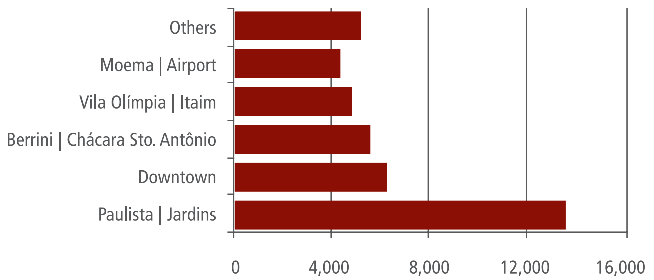
With the global supply more than doubling in just five years, hotel occupancy fell by almost half, provoking an intense rate war among competitors; this has resulted in a notable drop in revenues, ownership income, and, consequently, the value of the real estate.

As a consequence of the low profitability, the supply expansion stalled. In 2005, there were already practically no more new hotels under development and thus the supply stabilized.

Geographic Distribution

Currently, 34% of the city's hotel supply is concentrated in the Paulista/Jardins region. The city's Center region concentrates 16%, followed by Berrini/Chácara Santo Antônio with 14%, and Vila Olímpia/Itaim and Moema/Congonhas Airport with 12% and 11%, respectively. The remaining 13% are spread out among the other regions of the city.

Figure 2 - Distribution of Hotel Supply by Region (rooms)



Source: HVS

The region of Paulista/Jardins took over as the city's top spot, which previously had been the Center at the beginning of the 1990s.

After that, due to the lack of available land, and following the

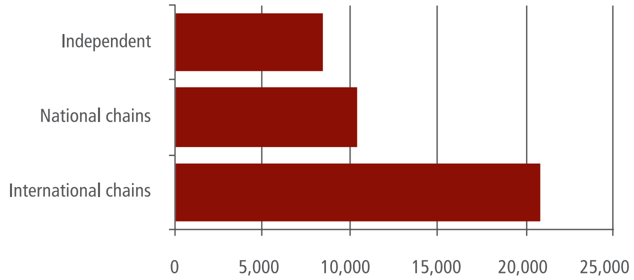
4. This supply excludes motels, hostels, pensions, and serviced residences with predominantly monthly contracts.

relocation of commercial offices, hotel expansion in São Paulo spread to other regions such as Itaim, Berrini, Moema, and Chácara Santo Antônio, accompanying the development of the city.

Affiliation

Nearly 53% of the roomss belong to hotels managed by international chains, while 26% are associated with national chains and 21% are independent. This distribution is the complete inverse of that of 1990, when independent hotels had more than 50% of the city's supply. Since the 1990s, the supply of rooms affiliated with international chains has grown by nearly 1,000 rooms, to nearly 17,000.

Figure 3 - Distribution of Hotel Supply by Affiliation (rooms)



Source: HVS

During the expansion of São Paulo's hotel supply in the 1990s, the national and international hotel chains took advantage of the opportunity to firmly establish themselves in the São Paulo market.

Segmentation

About 90% of São Paulo's lodging demand belongs to the business and events segments and is attracted by the city's strong economy and by the event calendar that includes major attractions such as the Formula 1 race, the Salão do Automóvel auto show, and Fashion Week, as well as other large events in various sectors including textile, health, and civil construction.

Although São Paulo has the potential to capture leisure tourism with its historic buildings, museums, concert venues, and restaurants, this segment still represents a small part of the city's hotel market, generating only about 10% of the lodging demand. Many of the people who travel to São Paulo for leisure stay at the houses of relatives and friends.

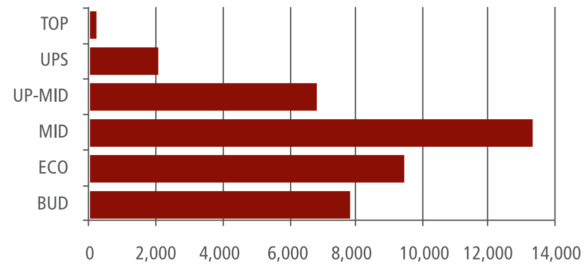
Nevertheless, due to the strength of the business and events segment in the city, São Paulo's hotel supply is quite diversified in terms of standard of quality and sophistication. To understand how the supply is distributed among the various categories, the hotels were classified according to their physical structure, services offered, and estimated average daily room rate, in the following categories:

- TOP: over R$ 600;
- UP: between R$ 300 and R$ 600;
- UP-MID: between R$ 170 and R$ 300;
- MID: between R$ 130 and R$ 180;
- ECO: between R$ 95 and R$ 155;
- BUD: up to R$ 95.

One particularity of the São Paulo market is the existence of the UP-MID segment. As the São Paulo hotel market is the largest and most competitive in Brazil and is highly professionalized (with a major presence of hotel chains), the UP-MID segment came about naturally as an intermediate positioning between the MID and UPS hotels.

Due to strong competition within the intermediate segments of the city's hotel market, there are intersections of daily room rates among the ECO, MID, and UP-MID hotels. This is the case because when the oversupply of rooms occurred in São Paulo, there were price wars among the hotels in these categories, and some hotels raised or lowered their rates (in relation to the average standards of each market segment) for reasons of business strategy or location.

Figure 4 - Distribution of Supply by Category (rooms)



Source: HVS

The TOP hotels represent only 1% of the total supply of the São Paulo market, with 3 small and medium-sized hotels – Fasano, Emiliano, and Unique – totaling 212 rooms. These hotels offer more personalized services and more sophisticated amenities and equipment than the UPS, and for this reason they have significantly higher average daily room rates.

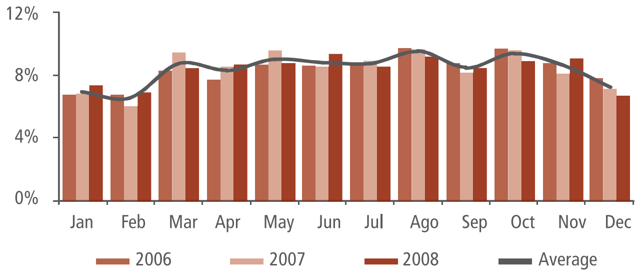
The supply in the UPS segment represents 5% of the total of the city's hotel rooms, with 6 establishments managed by large international chains. The UP-MID and MID segments combined make up 51% of the São Paulo market. Both categories consist mainly of Brazilian and international chain hotels.

The ECO and BUD segments represent 24% and 20%, respectively. They are made up of some brands of chain hotels, as well as various independent hotels that did not accompany the evolution in physical infrastructure and level of service of the new hotels.

Seasonality

Because the São Paulo hotel market is highly dependent on the business activity that drives the city's economy, it suffers considerable seasonality.

Figure 5 - Seasonality of Demand (% of annual demand)



Source: HVS

Since companies concentrate their trips and events mainly during the week, and São Paulo still has not been successful in attracting leisure tourists on weekends, the hotels always reach a high level of occupancy between Monday and Thursday, with a sharp drop in occupancy on weekends.

A similar drop occurs in the months of January, February, and December, when the business activity of companies is low and, consequently, hotel occupancy is reduced.

The UPS Hotels of São Paulo

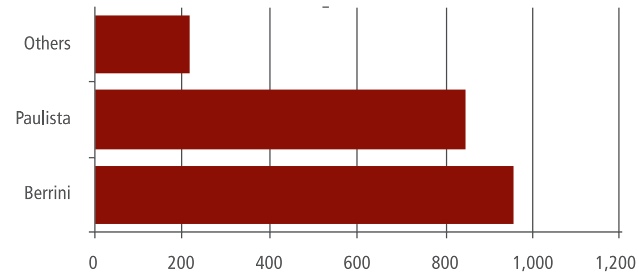
The six hotels that fit within the UPS category in São Paulo currently fly the flags of major international administrators, which have an interest in establishing their best brands within an important market like that of São Paulo. In fact, three of these hotels are the property of the administrators themselves: Hilton, Hyatt, and Inter-Continental.

Among the hotels with administrative or lease contracts are the Sofitel, the Renaissance, and the former Gran Meliá Mofarrej, which was closed for renovations during part of 2008 and will reopen in 2009, administered by Tivoli, a Portuguese hotel operator.

Geographic Distribution

The group of hotels in the UPS category is currently made up of 6 properties, totaling 2,036 rooms, distributed mainly between the regions of Berrini (47%) and Paulista (42%).

Figure 6 - Distribution of UPS hotels by Region (rooms)



Source: HVS

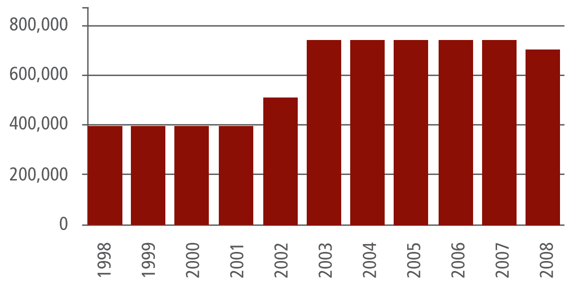
Supply

Of the current UPS hotels, the first to be inaugurated was the former Gran Meliá Mofarrej, on Paulista Avenue, in the mid 1980s.

Only in the second half of the 1990s did the city have its supply expanded, with the inauguration of three more hotels – two in the Paulista region, the Intercontinental and the Renaissance, and the Sofitel in the Ibirapuera region. Until 1997, almost all of the UPS hotels in the city were concentrated next to Paulista Avenue, and only in 2002 were two additional sophisticated hotels – the Hilton Morumbi and the Gran Hyatt – opened in the Berrini region, thus expanding by more than 50% the city's supply of rooms in the UPS category.

In 2008, the former Gran Meliá Mofarrej was closed for several months for renovation, thereby reducing considerably the supply in that year.

Figure 7 - Supply of UPS Hotels (in room nights)



Source: HVS

Demand

The demand met by the UPS hotels fell significantly between 1998 and 2000 due to the impact of the inauguration of various hotels belonging to the UP-MID segment, precisely at the moment when the UPS hotels raised their rates in Reais as a consequence of the valuation of the dollar. This sparked a migration on the part of the demand toward the new supply of hotels, even though the new hotels were one category lower.

Starting in 2001, the UPS hotels reduced their rates and the demand began to react, recovering the clients who had migrated to the UP-MID segment. Between 2003 and 2006, the demand made a strong recovery, influenced by a good period of the global economy and by the recovery of the São Paulo hotel market as a whole.

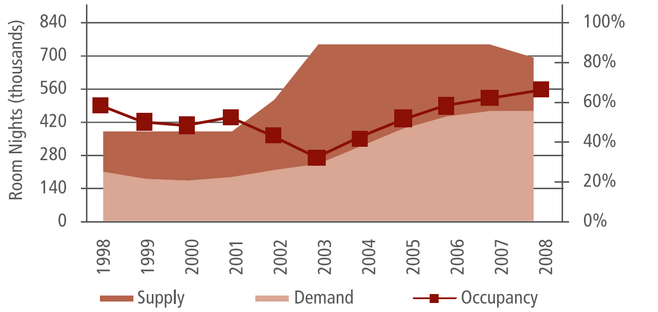
The demand induced by the inauguration of the Hilton Morumbi and Gran Hyatt hotels was also responsible for the intensity of the growth in demand.

In 2007 and 2008, the growth in accommodated demand was more measured, limited by the seasonality restrictions of the market. As a general rule, when the city's average annual occupancy reaches a level above 65%, it means that on weekdays the occupancy nears 100%, which results in the generation of latent demand.

Average Occupancy[5]

As a consequence of the variations in supply and demand of the UPS market of São Paulo, the average occupancy of these hotels also varied during the period analyzed. Between 1998 and 2000, the occupancy followed a decline trend, falling from 60% to almost 50%. In 2002, this index began to show signs of improvement, influenced by the recovery of demand. But with the opening of the Berrini hotels, occupancy suffered a drastic drop over the following two years, reaching a low of 37% in 2003.

Figure 8 - Supply, Demand, and Occupancy of the UPS Market



Source: HVS

With the stabilization of the supply and the continuous increase in demand during the following years, the average occupancy rate of São Paulo's UPS hotels went from 37% in 2003 to 66% in 2008.

Average Daily Room Rate

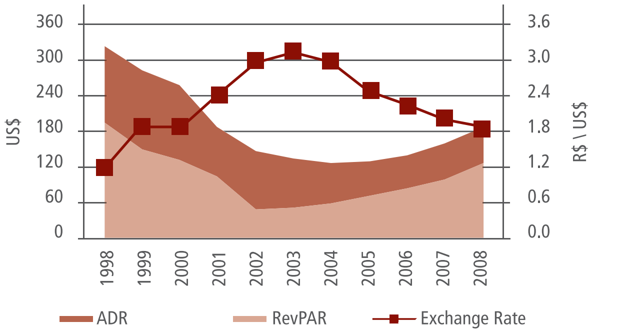
The average daily room rate of São Paulo's UPS hotels, measured in dollars (December 2008 dollars, updated according to the U.S. Consumer Price Index) fell markedly between 1998 and 2000, going from US$ 320 to less than US$ 200, due to the drop in demand as well as the valuation of the dollar with respect to the Real. In 2002 there was new large drop in average daily room rate, justified by the drop in occupancy of the hotels due to the 50% increase in the supply. This decline in the daily room rate (in dollars) continued until 2004, when it reached the level of US$ 122, totaling a real value loss of 62% since 1998. Since then, thanks to the recovery of the occupancy rate, which was helped by the devaluation of the dollar, the average daily room rate began to recover and reached a value of US$ 184 in 2008.

Measured in Reais (December 2008 Reais, updated according to the Brazilian Consumer Price Index), the average daily room rate of São Paulo's UPS hotels increased by 28% between 1998 and 1999, justified exclusively by the valuation of the dollar with respect to the Real. Starting in the year 2000 the average daily room rate began to drop off, mainly due to the fall in occupancy, and when occupancy began to recover, it was the devaluation of the dollar that was responsible for the continued decrease in the daily room rate, which fell from

5. The analyses of market performance include the 6 properties in this category.

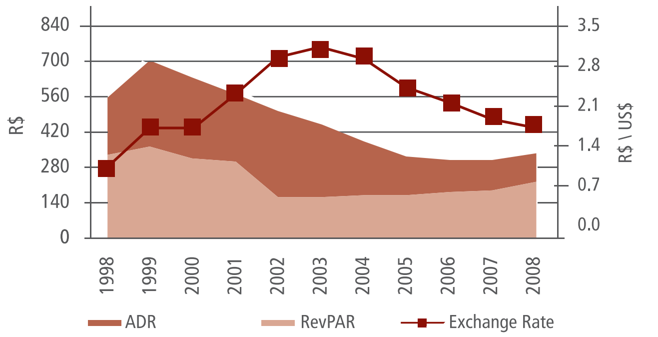
nearly R$ 700 in 1999 to R$ 307 in 2006, a 56% decrease in real value. In 2007, the effects of the market recovery began to have an effect on the average daily room rate, which increased over the last two years and reached R$ 330, still far from the value reached in 1999.

Figure 9 - Performance of the UPS Market (prices in 2008 U.S. dollars)



Source: HVS

Figure 10 - Performance of the UPS Market (prices in 2008 Reais)



Source: HVS

RevPAR

Representing the interrelation of occupancy rates and average daily room rates, the RevPAR (revenue per available room) in dollars showed a 47% drop between 1998 and 2000, and after the stabilization in 2001, there was a significant new drop in 2002, of 54%. Since that moment, the RevPAR began to recover year after year, an average of 17% per year through 2008. In dollars, the RevPAR started at US$ 190 in 1998, fell to US$ 46 in 2002, and rebounded to the level of US$ 120 in 2008.

The index in Reais started at R$ 325 in 1998 and increased to R$ 364 in 1999. In the three following years, the RevPAR showed consecutive drops, the most significant being a 47% drop in 2002, when the index reached R$ 159. Between 2002 and 2005, the RevPAR in Reais oscillated little, practically remaining at a constant level. In 2006 a recovery began that intensified in 2008 (15%), with that year's RevPAR closing at R$ 221, still well below the peak value, which was reached in 1999.

The MID and UP-MID Hotels of São Paulo

The MID and UP-MID categories are made up of hotels with daily room rates in the ranges of R$ 130-180 and R$ 170-300, respectively. These hotels are marketed to mid to high-level executives and offer a complete set of services. The absolute majority of these hotels is managed by national and international chains, under banners such as Blue Tree Towers, Transamérica Flats, Quality Suites, and Mercure.

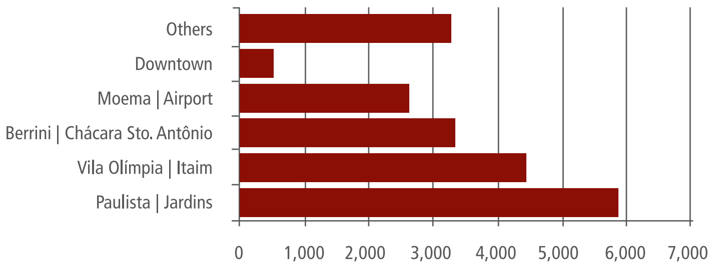
The majority (66%) of the hotels that opened in São Paulo at the end of the 1990s and the beginning of the current decade belonged to the MID category. When this happened, the MID segment was practically entirely restructured.

Due to the high competitiveness existing within the MID segment as well as the consequences felt by the UPS hotels, there naturally occurred a subdivision between the two segments, categorized as UP-MID.

Geographic Distribution

Currently, the group of hotels in the MID and UP-MID categories is made up of 91 properties, totaling 16,797 rooms that are distributed in the following manner:

Figure 11 - Distribution of MID and UP-MID Hotels by Region (rooms)



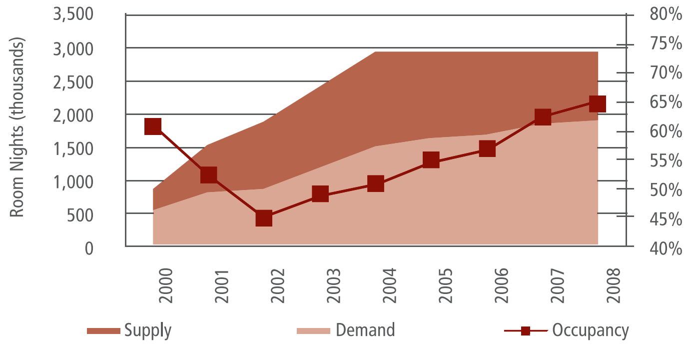
Source: HVS

These segments represent 42% of São Paulo's total supply of hotel rooms and 87% of these units were inaugurated in the last 10 years. The Center region includes less than 3% of the total supply of hotels in this category, and regions of more recent development such as Vila Olímpia/Itaim and Berrini/Chácara Santo Antônio represent 22% and 17%, respectively.

Supply, Demand, and Average Occupancy[6]

After the period of major development of new hotels between 1998 and 2004, the supply of rooms in the MID and UP-MID categories practically stabilized at a level three times higher than that of four years prior.

Figure 12 - Supply, Demand, and Occupancy of the MID and UP-MID Markets



Source: HVS

The demand showed continuous growth during the entire period analyzed. Between 2000 and 2002, this growth was not sufficient for occupying the entire supply that would emerge on the market. However, starting in 2003 the growth of demand benefited from a good period in the global economy and surpassed the growth of supply, thereby making occupancy recover from 45% in 2002 to 65% in 2008.

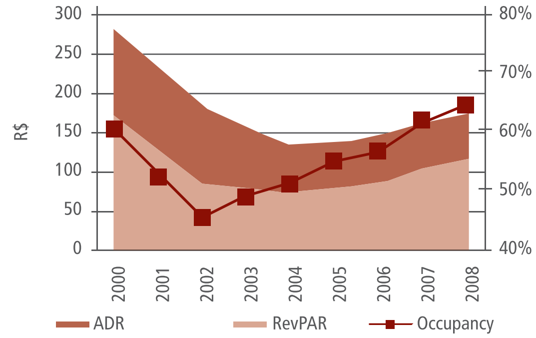
When the average annual occupancy reaches this level, its growth becomes more measured due to the seasonal characteristics of the São Paulo market, which generates a latent demand during the peak occupancy periods.

Average Daily Room Rates and RevPAR

Measured in Reais (December 2008 Reais, adjusted according to the Brazilian Consumer Price Index), the average daily room rate suffered a long period of decline during the years analyzed, going from R$ 277 in 2000 to R$ 137 in 2004, a drop of more than 50%. In 2004, with the stabilization of the supply and with the growing occupancy rate, the average daily room rate also began to recover, and in 2008 it reached a value of R$ 172, still much lower than that of 2000.

The RevPAR behaved very similarly, falling from R$ 168 in 2000 to R$ 69 in 2004, a drop of 59%. However, this indicator shows signs of a stronger rebound thanks to the recovery in occupancy, reaching the level of R$ 111.

Figure 13 - Performance of MID and UP-MID Markets



Source: HVS

Perspectives and Opportunities

Currently, the major investment opportunity in the São Paulo hotel market is in the acquisition of hotels in operation.
Still today, as a general rule, the hotels have an economic value inferior to the replacement cost, with very few exceptions in specific categories and/or regions of the city. This means that those interested in investing in hotels in São Paulo should be more focused on acquisition opportunities than on development opportunities.

The São Paulo hotel market is in recovery. With the stable supply and the growing demand, occupancy rates are rising and, as a consequence, so are daily room rates. This tendency should continue for at least the next four years, until a new cycle of hotel development begins.

The investor that acquires a hotel today will purchase the property for a relatively low price and will benefit from the recovery in sales that will continue during the coming years. At some point, this economic value will surpass the replacement cost, and that moment will be the right time to develop new hotels.

Among the alternatives for acquisition, the best ones tend to be the properties in the MID and UP-MID categories. These are the categories that suffered the most during the most recent

6. The analyses of market performance include 41 properties, which represents 48% of the total supply of hotel rooms in these categories in the city of São Paulo.

development cycle. In these segments there was the greatest increase in supply and, consequently, the greatest decreases in occupancy and profitability. For this same reason they are the segments that show the greatest potential for recovery.

The BUD and ECO hotels tend to become economically viable more quickly than the higher categories, as the competition in these categories is much lower. These are currently the most profitable hotels in the city of São Paulo. ECO hotels, for example, show sales similar to that of the MID hotels, despite requiring a level of investment that is 30% to 50% lower.

In 2008, the average annual occupancy of the market, including all of the hotel categories, reached a level that is considered high for a market with the seasonal characteristics of São Paulo. Therefore, before this year, a large part of the occupancy recovery had already occurred.

Starting in 2009, the recovery of profitability will be led, in large part, by an increase in the daily rates, which are still far from the levels registered at the end of the 1990s.

With regard to the current economic crisis, it should not affect the São Paulo hotel market with an intensity sufficient to interrupt the recovery process that is already underway. The average annual occupancy level of 65% in 2008 indicates that on several days of the week during the high season months, São Paulo's hotels are practically fully booked. This is a strong indication that there already exists a significant quantity of latent demand. This unaccommodated demand during the high season should be large enough to prevent a drop in the average annual occupancy.

The drop in occupancy will likely be felt only during the low season months, as occurred in December 2008, when there was a 3% decrease in occupancy with respect to December 2007.

The expectation is that the average occupancy for 2009 will be similar to that of 2008. This stability, at the level of 65%, is sufficient for the hotels to maintain their strategies of increasing their daily room rates and their profitability With the resurgence of economic growth in Brazil and in the rest of the world, after the end of the worst period of the economic crisis, the demand for lodging will grow again, exerting even stronger pressure on prices.

This outlook of recovery is even more guaranteed in the medium term because of the 2014 World Cup, which will be hosted by Brazil, with the city of São Paulo as one of the main locations of the event. As a result of investments in infrastructure and the promotion of Brazil as a tourist destination, São Paulo's economy will be stimulated even more and the inflow of tourists will increase.

HVS

Salvador

Market Overview

Salvador

Bahia is the strongest economy of the Northeast, responsible for more than 30% of the region's GDP. Since 1996, the state has shown constant economic growth, at levels equal to or even higher than that of Brazil as a whole. This has been occurring mainly due to the diversification of the economy by way of new investments in the industrial sector, especially the Petrochemical Pole of Camaçari, 30 kilometers from Salvador, and the more than 60 industries in various branches, from chemical and automotive to the textile and food sectors.

The city of Salvador is the capital of Bahia and the second most important economy of the state, representing nearly 24% of Bahia's GDP. Its population is approximately 2.9 million, while Greater Salvador has a population of almost 3.7 million.

Salvador is one of the most visited cities in the country, visited by Brazilians and foreigners alike. In addition to being a site of business and events, the city is rich in historical, cultural, and natural attractions. It is also a necessary gateway for tourists who travel to other renowned vacation spots in its vicinity, including Praia do Forte, Ilha de Itaparica, Morro de São Paulo, Ilha de Boipeba, Costa do Sauípe, and Chapada Diamantina.

In terms of tourism, its location is quite privileged – about 1,000 kilometers from the main capitals of the Center-west and Southeast (São Paulo, Rio de Janeiro, Belo Horizonte, Brasília), which are considered the most representative generators of domestic tourism demand. The flight duration from these markets to Salvador International Airport is convenient, generally not more than two hours.

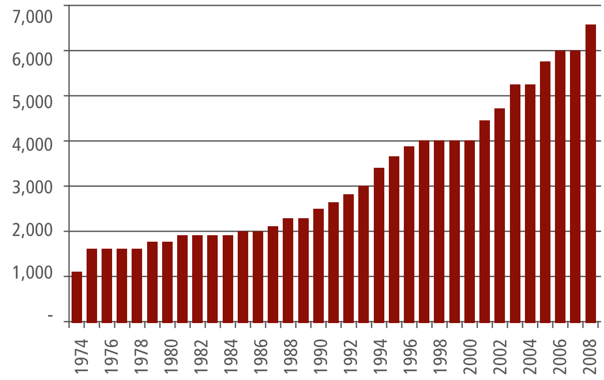
Salvador International Airport represents more than 30% of the volume of air-travel passengers to Northeast. With nearly 6 million passengers transported in 2008, the airport stands out as one of the country's top five in passenger volume, behind only the airports of Guarulhos, São Paulo, Brasília, and Rio de Janeiro (Galeão).

History of the Hotel Supply

In December of 2008, Salvador had a rated hotel supply of slightly more than 6500 available rooms in 65 hotels[7].

The supply of hotels currently in place was developed over the course of the past 34 years.

Figure 1 – Evolution of the Supply (rooms)



Source:Guia 4 Rodas

Between 1974 and 2008, the number of hotel rooms in Salvador grew 5% per year, on average. This evolution was relatively constant, with some leaps in expansion during certain periods. Mainly due to the lack of credit and the absence of a well-structured market, the development of the hotel supply was slow and gradual until the end of the 1980s. Starting in 1989, with the rise of the condo-hotel concept, the development of new hotels in Salvador was intensified. This tendency lasted until 1997, the year in which the hotel supply stabilized, with growth resuming only in 2001.

From 2001 to 2003, the added hotel supply was of 1240 rooms, some made possible by condo-hotels and others by way of conventional investments, in which there were no government incentives for the sale of newly-constructed apartments.

Between 2004 and 2007, more than 15 hotels (most of them small) were opened, resulting in an increase of 761 rooms in the supply. The main hotels opened during this period were the Iguatemi Business Hotel and the Web Hotel, independently operated, and the Holiday Inn Salvador and the Convento do Carmo Hotel, managed by the international operators InterContinental and Pestana, respectively.

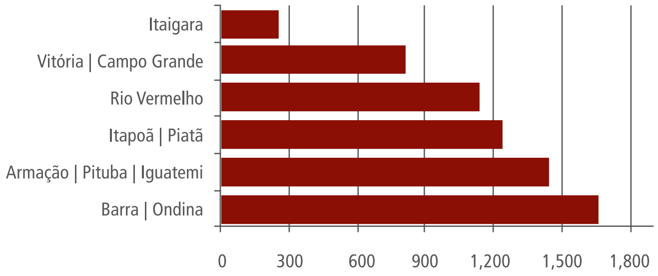
In 2008, two more hotels opened: the Catussaba Business Hotel and the Gran Hotel Stella Maris, adding 468 rooms to Salvador's hotel market.

Geographic Distribution

Salvador has a hotel supply that is well distributed. The hotels are located mainly on the coast, but also in the historic center and in the Iguatemi district.

7. This supply excludes motels, hostels, pensions, and serviced residences with predominantly monthly contracts.

Figure 2 - Distribution of Hotel Supply by Region (rooms)



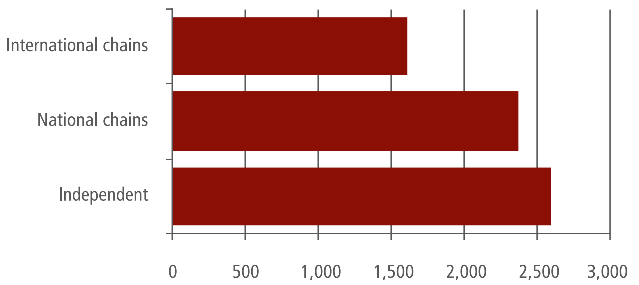
Source: Guia 4 Rodas

In the regions of Barra/Ondina (25%) and Rio Vermelho (17%) there is a concentration of hotels with modern facilities for medium and large-scale events. Meanwhile, in the region of Armação/Pituba/Iguatemi (22%), the new business center of Salvador, the segment with the largest development potential is that of business accommodations. Finally, as for the hotels located in the north of the city, such as those in Itapoã/Piatã (19%), the predominant market of leisure travel has shaped the hotel offerings in that region.

Affiliation

The international chains (Accor, Pestana, Vila Galé, InterContinental and Best Western) and national chains (Othon, Tropical, and Blue Tree) represent, respectively, 25% and 36% of the hotel supply (in rooms). Some of the hotels are the property of the chains, while others are managed under management or franchise agreements.

Figure 3 - Distribution of Hotel Supply by Affiliation (rooms)



Source: HVS

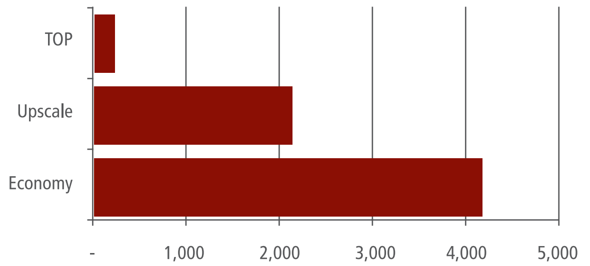
Even with a smaller total number of rooms, the independent operators represent 39% of the rated hotel supply. This is a clear indicator of the potential for market share growth of the national and foreign hotel operators in the local market in the coming years, which depends on the continued expansion of domestic demand and the recovery of the international travel market.

Segmentation

In terms of hotel segmentation, Salvador is still in an early stage of development. For this reason, a large part of the hotels can be classified in just three categories, defined according to the estimated average room rate:

- TOP – over R$ 300;
- UPS (upscale) – from R$ 150 to R$ 299;
- ECO – under R$ 150;

Figure 4 - Distribution of Supply by Segment (rooms)



Source: HVS

In Salvador's hotel market, the economy hotels are predominant. While there is an availability of nearly 2,170 rooms in the upscale category, the economy hotels surpass 4,220 apartments (approximately 65% of the total number available).

As for the TOP segment (2% of the local availability), it consists of "charming hotels" – elegant establishments, with exclusive services – which are mentioned in this study because they compete marginally with the upscale market.
Besides the aforementioned categories, it is necessary to make a brief mention about resorts, which, though not located in Salvador itself, attract a large number of tourists and, consequently, influence the local market for leisure and events.

- As for the demand segments of Salvador with regard to the purpose of travel, three groups have been identified: leisure, business and meetings.

- The leisure segment is made up of domestic and foreign tourists. Salvador is the Northeast city that stands out the most in Brazil's tourism scene. For this reason, it receives a large number of tourists with this motivation. These tourists look for lodging in various categories, from economy (predominantly domestic tourists) to luxury (for tourists with greater purchasing power). Currently, the tourists are divided between the hotels in Salvador and the growing number of resorts to the north of the city. The periods of greatest demand for leisure travel are the school vacation months (December, January, and July) and extended holidays.

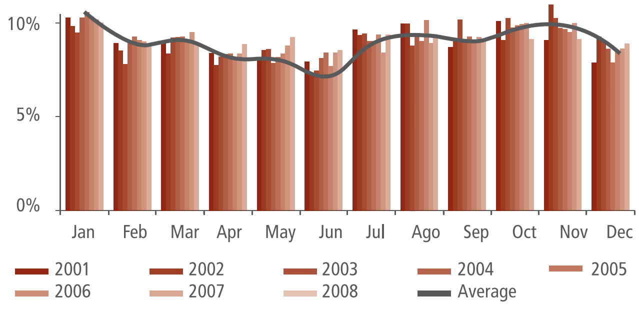
- As the main economic pole of the Northeast, Salvador also has strong demand from the business community: businesspeople, technicians, and other company employees who visit the city. The business segment has strengthened, in parallel with local economic development, and it has spurred growth in the hotel industry of the entire region. The periods of greatest business demand occur from March to June and from August to November.

- The meetings segment is also strong in Salvador. Small and large company events, such as training programs, incentive trips, and conferences, bring activity to the city's hotels. In recent years, the resorts of the Costa dos Coqueiros have attracted a significant part of this demand with their ample facilities, modern equipment, and high touristic attractiveness. The seasonality of the events segment is similar to that of the business segment, with greater demand during the second semester.

Seasonality

Salvador's three tourism segments and its high attractiveness as a destination result in a low seasonality in its hotel demand, especially as compared to the higher seasonality of other destinations in Brazil.

Figure 5 - Seasonality of Demand (% of annual demand)



Source: HVS

The peak in demand occurs in January, a school vacation month with ideal weather for leisure travel. In months with lower temperatures, more frequent rain, and less business activity, it is common for hotel occupancy to fall considerably, as can be noted in the month of June. The higher concentration of demand in the second semester occurs due to the greater number of events held in the city during this period.

Upscale Hotels in Salvador

The group of hotels in the upscale category is made up of nine properties, which represent a total of 2,169 rooms. Their distribution in Salvador is concentrated between Rio Vermelho and Ondina (67% of the establishments).

Supply

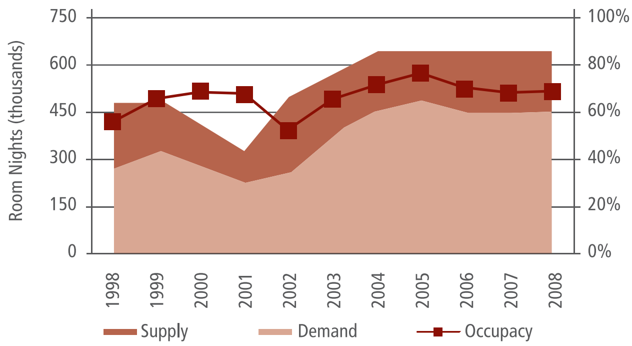
During the period analyzed, the supply of hotels presented two clear oscillations. The first, between 1999 and 2001, was marked by the closing of the old Le Méridien. After ceasing its operations in 1999, the hotel underwent a major restoration and reopened in 2002, under the administration of the Portuguese group Pestana. The second, between 2002 and 2004, occurred due to the opening of two new enterprises in Salvador, which added approximately 400 rooms to the local hotel supply.

Between 2005 and 2008, Salvador's upscale hotel supply remained virtually stable (+1% per year). During this period, the only change registered was the opening of the Gran Hotel Stella Maris and of some TOP hotels which added a combined 460 rooms to the city's hotel market.

Demand[8]

The evolution of Salvador's upscale hotel demand follows, for the most part, the oscillation of the total supply of this market in the city. Only between 2006 and 2008 was there a mismatch, characterized by an increase in the supply and a relative stabilization of the demand.

Figure 6 - Supply, Demand, and Occupancy of the Upscale Market



Source: HVS

8. The market performance analyses include 81% of the hotel rooms belonging to the UPS segment, including all of the hotels managed by national and international hotel chains.

Between 1998 and 2000, the demand remained at around 294 thousand room nights per year, being affected mainly by the increased economic activity derived of the privatization of state companies and by the growth of industrial activity associated with the petrochemical sector.

In 2001, there was a strong fall in demand, of approximately 20%. The main reasons for this fall were the reduction of processes of privatization of state companies, the international economic crisis (especially in Argentina), the domestic economic crisis (which was intensified by the electric energy crisis), and the international terrorist attacks (which drastically reduced air travel throughout the world).

Hotel demand began to grow again with more intensity only between 2002 and 2005. During this period, the average increase in the number of room nights was close to 23% per year, reflecting the return to national economic growth and the commercial efforts induced by the recently-opened hotels in Salvador's upscale hotel market.

Since 2006, however, the demand for lodging has suffered reductions (-3% per year). The main reasons were the development and increasing of resorts segment on the coast north of Salvador, as well as the increased Brazilian demand for international destinations through the third trimester of 2008, due to the increase in value of the Real with respect to the dollar during this period.

Air travel is the main mode of access to the city for Brazilian and foreign tourists who stay at Salvador's rated hotels. Accordingly, it is to be expected that there would be a correlation between the volume of passengers at the city's international airport and the demand for lodging. Nevertheless, between 2005 and 2008, this correlation was nonexistent. Despite the average annual growth of 10% in passenger air travel (according to data from Infraero), the demand for hotels decreased considerably during this period. It is plausible that the increased volume of passengers was induced by hotels and resorts in other destinations near Salvador, with little direct benefit to the local hotels.

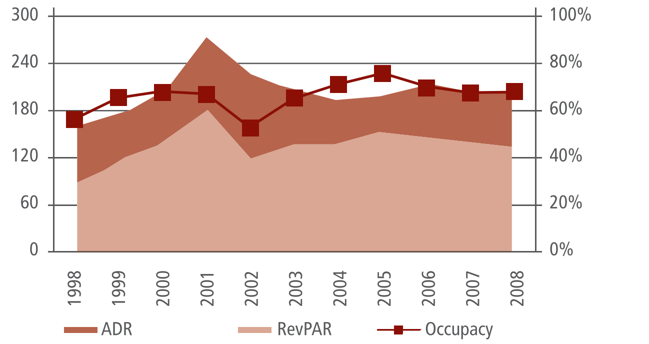
With the redirectioning of international trips by Brazilian residents toward the domestic market in the coming years (due to changes in exchange rates), it can be expected that the correlation between the volume of air passengers and the demand for lodging in Salvador will return to being positive.

Average Occupancy

Throughout the historical period analyzed, with the exception of 1998 and 2002, the occupancy of Salvador's upscale hotels has remained at a level above 65% per year, on average.

In 2005, the average occupancy of the market reached a peak of 76%. In the years that followed, as a result of the increase in supply and the slight reduction in demand, the average annual occupancy fell to 68%.

Figure 7 - Performance of the Upscale Market
(prices adjusted for inflation, shown in 2008 Reais)



Source: HVS

The main reasons that explain the high rates of occupancy in the upscale lodging market in Salvador are the following: dependence on three market segments, rather than just one; the barriers to entry of new competitive hotels, such as the shortage of inexpensive and adequate land for hotel development; the proximity between Salvador and the main cities of permanent residence of domestic tourists; the success of the local government in promoting and structuring the regional tourism supply. In addition to these factors, the stagnation of the average daily room rate (in real value) in recent years has also contributed to the maintenance of high occupancy rates of Salvador's upscale hotels.

Average Daily Room Rate

The trend of increasing daily room rates (measured in December 2008 Reais, adjusted for inflation according to the Brazilian Consumer Price Index) in Salvador's upscale hotel market, at the end of the 1990s, was interrupted in 2001 after the terrorist attacks of September 11th (and the resulting global decline in international travel) and the deceleration of the growth in domestic travel. Since then, the low domestic tourism consumption in the country until 2005, the growth in the regional hotel supply, and the increase in value of the Real with respect to the dollar until the third quarter of 2008 were determining factors in the stabilization of the average daily room rate in the city.

RevPAR

The oscillation of RevPAR (revenue per available room) during the historical period analyzed accompanied the variations in the average daily room rate. Only since 2006 has there been observed a slight mismatch due to the fall in average occupancy of the market. Despite the recent decline in RevPAR between 2005 and 2008, the average variation between 1998 and 2008 is positive, at 4% per year.

Economy Hotels in Salvador

The category of economy hotels in Salvador has had an evolution similar to that of the upscale category. This group of enterprises is made up of 51 properties, which represent a total of 4,221 rooms (65% of Salvador's rated hotel supply).

The supply is well distributed among the regions of the city, between Vitória/Campo Grande, Barra/Ondina, and Armação/Pituba/Iguatemi. Each region concentrates nearly 25% of the total number of hotel rooms in Salvador. The rest of the hotels are spread out in other regions of the city.

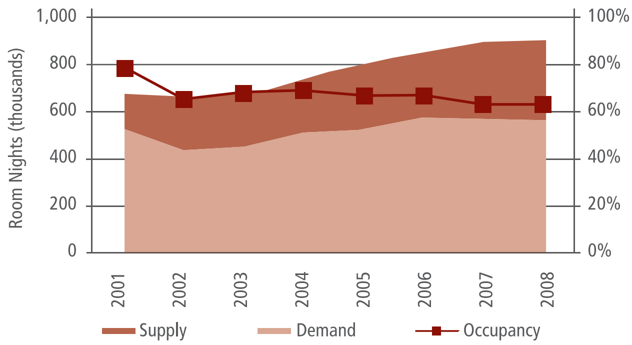
Supply

As with the upscale category, the supply of economy hotels in Salvador grew significantly during the period analyzed (2001 to 2008), though at a more constant rate (5% per year). The greatest jump in annual supply occurred in 2005 (13%), with the entry of 447 rooms into the market.

Demand[9]

From 2001 to 2008, the total number of room nights increased from 530 thousand to 574 thousand. While the average growth in supply was 5% per year, demand grew only 2% per year. This difference is explained by the terrorist attacks of September 11, 2001, and by the relative fall in local attractiveness as compared with other destinations in Salvador's competitive set starting in 2006, due to the increased strength of the Real and the promotional and structural efforts of other tourist destinations in the Northeast.

Figure 8 - Supply, Demand, and Occupancy of the Economy Market



Source: HVS

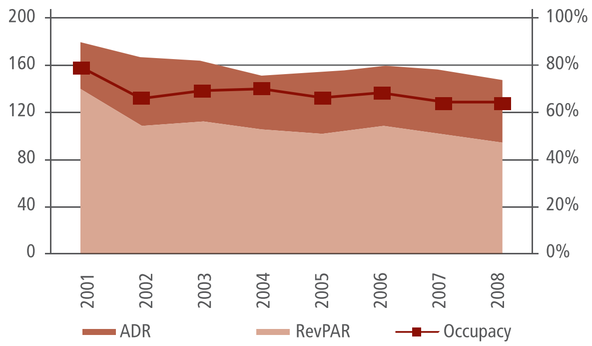
Average Occupancy

The result of the growth in supply at a slower velocity than that of demand is a declining rate of occupancy over the course of the historical period analyzed – from 79%, in 2001, to 64%, in 2008. Despite the drop, the level reached in the past two years is still reasonable, especially when compared with the levels of other national markets.

Average Daily Room Rate

The reduction of the average daily room rate was one of the strategies used by the economy hotels of Salvador in trying to contain part of the fall in the occupancy rate between 2001 and 2008. During this period, the rate reduction was of 17% (in December 2008 Reais, adjusted according to the Brazilian Consumer Price Index).

Figure 9 - Performance of the Economy Market (prices adjusted for inflation, shown in 2008 Reais)



Source: HVS

In the economy market, the increase in hotel supply is the main

9. The market performance analyses include 61% of the hotel rooms belonging to the economy segment, including all of the hotels managed by national and international chains.

explanation for the noted tendency of falling average daily room rates during the period analyzed.

RevPAR

The relation between the declining average daily room rate and the declining average occupancy resulted in an even more negative variation in the RevPAR (revenue per available room) between 2001 and 2008 (-33%). Besides failing to contain the drop in average occupancy of the hotels in the economy market, the sharp reduction of the daily room rate unfavorably impacted the revenue of these enterprises, which demonstrates that the rate reduction was an ineffective strategy for solving common problems in the market dynamic. It is to be expected that as the market becomes more and more professional, the adoption of such practices will become less common.

Perspectives and Opportunities

Between 2009 and 2012, five hotel enterprises have announced openings in Salvador: Pestana Bahia Lodge (2009), Caesar Business and Hilton (2010), Ibis (2011), and Mercure Boulevard (2012). In total, there will be an added supply of about 800 rooms, distributed between the economy and upscale categories. In addition to these, three boutique hotels are expected, located within the perimeter that comprises the historic center, the Comércio region, and adjacent areas.

In the public sphere, the state and federal governments will likely continue to invest in structuring, diversification, and promotion of the regional tourism supply. The primary credit sources that are showing an interest in financing the tourism and hotel sector are the Inter-American Development Bank (IDB) and Brazilian financial institutions. The focus of the investments will be the domestic market, by virtue of the considerable decrease in the international inflow of tourists to Brazil and the immediate cancellation of some air routes between Salvador and Europe in the short term, a reflection of the global economic/financial crisis.

Despite the negative outlook for the international market in the short term, the domestic demand should grow in the coming years. The devaluation of the Real with respect to the dollar, which started in the fourth quarter of 2008, discouraged Brazilians from traveling abroad and, consequently, redirected this demand toward the domestic market, thereby causing the leisure and convention segments to recover once again. The consolidation of this tendency will depend on the impacts of the international crisis on Brazil, which are still unclear, according to most analysts. If the growth in RevPAR resumes in the coming years, it is very likely that new upscale hotels in Salvador will once again become feasible, given the positive outlook of the Brazilian economy in the medium and long terms.

The likely choice of Salvador as one of the host cities of the 2014 World Cup will require standards of hotel services and infrastructure compatible with FIFA regulations, which may anticipate new investments in the city. However, its effect on the projections and viability of new hotels is unclear; therefore, specific studies will need to be conducted in accordance with each project. Still, the event is an important milestone, especially for the installation of new urban and tourism infrastructure for the city.

Within Salvador, some opportunities are more clear, such as the strong potential that the Iguatemi/Tancredo Neves region has for hotel development, along with development in the Paralela Avenue region. In addition, as established in the city's current master plan, other opportunities should arise for hotel development in the Armação region, where there will be incentives for the construction of new seafront hotels. Location within the city of Salvador has been an increasingly important factor for the business and event traveler; therefore, those hotels with the best locations present greater potential for recovery of RevPAR and increased profitability.

The medium to long-term outlook for the Brazilian economy is quite positive. The confirmation of these expectations should result in improved performance of Salvador's hotel market, which in turn will make other investments in the sector – whether through construction or through affiliation of the independent supply with the national and international operators – return to consideration.

About HVS

HVS is an international investment consulting firm specializing in the hotel, food & beverage, leisure, casino, convention, and time-share industries. Founded in 1980 in the United States, it currently has 32 offices around the world and performs over 2,000 projects annually, in more than 50 countries, for virtually every major industry participant.

Over the course of its 10 years of activity in Brazil, HVS has done consulting projects for more than 150 hotels and resorts in Brazil and other countries, in addition to preparing tourism development plans for the Brazilian states of Bahia and Maranhão. Today, its Asset Management division advises 14 hotels located in São Paulo, Rio de Janeiro, and Salvador. As the strategic manager of the Hotel Maxinvest Investment Fund, HVS supervises assets exceeding R$ 83 million (mounting approximately US$ 36 million).

In Brazil, HVS offers the following services:

- Feasibility analysis;
- Valuations and Appraisals;
- Business plans;
- Market research;
- Consulting for tourism real estate mixed-use projects;
- Hotel Asset Management;
- Strategic management of hotel investment funds;
- Consulting for tourism planning and management.

1. Based on 585 rooms in 50 different hotels in São Paulo. Estimate based on market research on recent transactions.

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