



Hospitality Directions Europe Edition*

Issue 16 September 2007

Jewels in the crown: Trends and outlook for Europe's luxury hotel sector

Strong demand for all things luxury - goods, travel and hotels - has made luxury big business and a highly competitive battleground for consumer's wealth. This robust demand, driven by global economic growth, is supporting growing global affluence and increasing numbers of High Net Worth Individuals (HNWI). In turn this has driven high corporate and leisure travel volumes. Today, more people can afford luxury travel and to stay in luxurious surroundings.



Ritz Carlton Hotel, Moscow

Introduction

Luxury hotel markets have been booming for the last few years and there is huge interest in this segment. Interest comes from consumers, investors, developers and owners. In the US alone, more than US\$11.5 billion in upscale and luxury lodging changed hands in the first half of 2007. Most experts do not see this interest waning in the near future, although this does not mean the sector can rest on its laurels as the aspirations of the consumer are changing fast. Having a point of differentiation will be increasingly crucial.

This article examines the market dynamics of the luxury hotel sector in Europe, key drivers of demand, leading players, changing segmentation, new brands and the importance of facilities such as spas to today's travellers. We conclude with an analysis of the economics and future outlook in general and a performance forecast for one key market, London, where average hotel room rates are expected to top £360 next year. This article features the key messages from our research supported by the views of some 11 key luxury hotel companies, investors and observers.

Key findings include:

Demand

- The concept of luxury is a moving target. Definitions and perceptions are changing and as a consequence the market for luxury is splintering (not cleanly though) into those for whom experiences are becoming more important and those for whom trophy consumption is key
- At the same time, staying at a luxury hotel has become more affordable for a wider segment of younger, increasingly aspirational and indulgent consumers

Supply

- The market is polarising in terms of price as the super luxury travel and hotel companies develop ever more exclusive and expensive experiences
- A younger guest profile is driving a new type of diversified contemporary luxury product often with a more informal lifestyle/boutique orientation and cross-over
- The traditional '*grandes dames*' are fighting back and refurbishing for the 21st century
- Many luxury hotel companies are pursuing out-of-room revenue growth opportunities, including premium in-room facilities, food and beverage outlets, and luxurious spas
- Spas are an essential luxury experience and help drive incremental revenues

Outlook

- More new brands and brand extensions are coming to Europe for those willing to pay for quality facilities, amenities and services above today's 'five star' standards e.g. Andaz by Global Hyatt, "1" by Starwood
- More operators will do their own versions of luxury. Contemporary offerings will bridge the gap between lifestyle and super luxury products e.g. SLS Hotels or Nikki Beach with a fun and entertaining take on luxury
- The market will polarise around affordable and super luxury products
- Key risks and challenges include satisfying the ever changing consumer; susceptibility to downside movements in GDP which impact wealth creation, corporate profits and travel; uncertainty in equity markets impacting the flow of capital into the hotel sector - particularly from private equity investors, while rising construction costs could prove a headache for the viability of some schemes.^{1 & 2}
- Luxury hotels will remain big business and taking London as an example, the forecast outlook appears positive.

Market dynamics

Luxury definitions are blurring

Luxury comes in many guises and defining a luxury hotel is challenging. As in the past, luxury is constantly evolving and means different things to different people. For some it may be a hotel offering simplicity, privacy and spiritual wellbeing whereas for others it may be 24 hour butler service or a personal shopper. Needs may differ according to the nature and purpose of the trip, the origin of the guest and the location of the hotel.

However, luxury is generally regarded as a combination of facilities and style and something you don't normally experience at home. Many consumers' homes are more luxurious than in the past and hence have raised the bar for the luxury hotel. At the same time as consumers have become wealthier, they have also become more aspirational in their outlook. Mid-income individuals also aspire to luxury travel and products. Ironically, some consumers are prepared to pay for luxury on credit.

Unsurprisingly no precise definition of what constitutes a luxury hotel exists, reflecting the fact that many operators have developed their own self-styled luxury product adding luxurious type items and services on the lower end. Some have added epithets such as 'Collection' to position themselves in the luxury space. To add to the confusion, some operators have taken to calling themselves '7 star' to imply an über-luxury product. Even at the high end though there are varying degrees of luxury.

¹ Financial Times, Fresh turmoil in world equity markets 11 August 2007

² Retail Week, 13 July 2007, The Lap of Luxury

Key message:

Definitions and perceptions of luxury are changing

“The word luxury has certainly become an overused term but that said, the standard of luxury is now defined by the consumer’s expectations and experience”

Paul Kerr, Joint Managing Director, *Small Luxury Hotels of the World*

“I wouldn't say luxury was becoming more difficult to define but suggest that people's perception of luxury is changing, i.e. for many, space and privacy now define luxury”

Joanne Watkins, PR Director Europe, *Shangri-La Hotels & Resorts*

“In this day and age, luxury can be found in many people's homes. What really defines (it) is the ability to equal or exceed what is normally found in people's homes”

Stuart Johnston, GM *Brown's Hotel (RF Collection)*

“Luxury has forever been associated with money and, because the nature of the wealthy classes is changing (demographics), the nature of luxury is changing”

Erik Haugen, Chief Executive, *Kiwi Collection*

“Luxury ...also means scarcity and somehow difficult to achieve both in terms of time and money”

Jan Jansen, *The Rezidor Hotel Company*

“Luxury can't simply be governed by price though of course it is an indication as with any commodity”

“In addition luxury has different connotations around the world”

Paul James, Regional Director of Sales & Marketing, *Starwood Hotels & Resorts.*

Source: PricewaterhouseCoopers research 2007

Our research revealed the following observations from luxury operators and marketing consortia:

Experiences are more important than tangible features and benefits

All those we spoke to concurred on this point feeling that a unique and original experience had become more valued, in general, than trophies of consumption, although they still remain important for many. The nature of the experiences consumers seek out can vary enormously.

Key Message:

Its all about experiences not facilities

“High net worth and true luxury travellers are seeking customized experiences. They want access to the undiscovered and different. Behind the scenes tours, cooking lessons with the chef, shopping in local villages etc. Essentially, what can hotels do to wow very well travelled guests who want to go home and brag to their friends they have done something others have not!”

Paul Kerr, Joint Managing Director, *Small Luxury Hotels of the World*

“Exclusivity is considered to be a luxury, but everything that is seen as luxury, is not necessarily exclusive. Price is not the issue. The uniqueness and singularity of the experience is the key.”

Regis Perruchot, Hotel Business Director, *Splendia Hotels*

“The shift in focus of luxury moving from ‘product’ to ‘experience’ is indicative of the evolution of customer experience and expectation e.g. ‘Girls in a Lodge’ package at the Westin Turnberry Resort combines product (exclusive use/ Westin Facilities) with experience (value added champagne, spa treatments, DVD etc) and is a classic example of ‘Luxury Programming’ in this environment.”

Paul James, Regional Director of Sales & Marketing, *Starwood Hotels & Resorts.*

“At Hotelito Desconocido in Mexico, a 50-acre eco reserve which has no electricity, guests raise a flag on their deck in the morning and fresh coffee is delivered in minutes. In a place illuminated by candlelight and no TV, guests experience luxury in a different way”

Paul Kerr, Joint Managing Director, *Small Luxury Hotels of the World*

Source: PricewaterhouseCoopers research 2007

Trading up (and down)

As experiences become more important, old models for understanding consumer behaviour no longer apply. With no ‘right’ way of doing things consumers are increasingly willing to splash out on things they value but economise on others.³ For example, those we spoke to told us that spas were considered a key experience of staying at a luxury hotel which consumers value and are prepared to pay for. Whilst they may well book that £500 a night spa resort they may get there by flying a no-frills airline booked on a discount website.⁴

³ “The secret of Lifestyle Hotels popularity is simple: they are in tune with the needs of the new, complex consumer” Hospitality Directions Europe, September 2005

⁴ Adapted from the 2006 Travel & Tourism Market research Handbook, Richard K Miller & Associates www.rkma.com

Luxury has become more affordable and accessible

Widening disposable incomes mean more consumers are able to buy and experience luxury products at a variety of levels. The top end of the lifestyle and boutique sector also provides a luxury experience or at least luxury elements at more affordable and accessible prices. Today, staying at a luxury hotel has become more affordable for more people, even if only for a once in a life time experience.

Does this mean luxury has become less exclusive? Not necessarily, because at the same time there continue to be plenty of opportunities to develop ever more exclusive and expensive experiences. New brands and brand extensions are also being developed for those affluent travellers willing to pay for facilities, amenities and services above today's 'five star' standards.

Key message:

Luxury is becoming more affordable

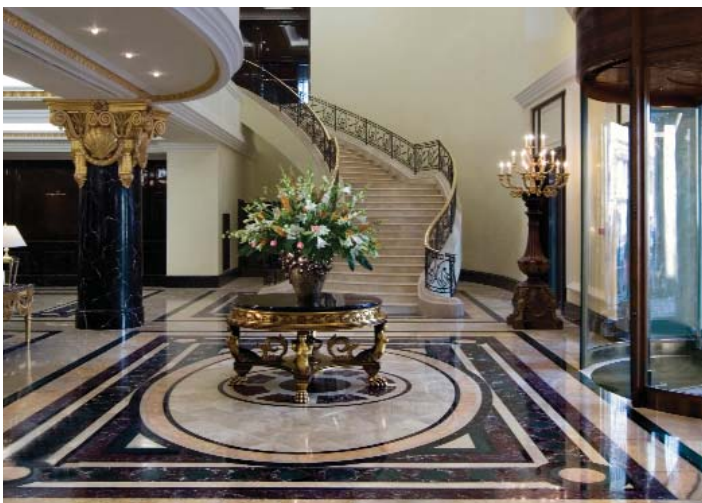
"There are more people aspiring and wanting to be surrounded by luxurious products and properties"

Stuart Johnston, GM Brown's Hotel (Rocco Forte Collection)

"Luxury today is actually within the reach of many people ...as people around the globe get exhausted consuming luxury goods, they increasingly are looking for luxury experiences. Different people are looking for different things."

Erik Haugen Chief Executive, Kiwi Collection

Source: PricewaterhouseCoopers research 2007



"At £8,000 a night luxury is clearly not becoming more affordable at the Ritz Carlton, Moscow"

Sergey Logvinov, Head of PR, Ritz Carlton Hotel, Moscow

Demand drivers

Motivations for buying luxury goods in general

The continued demand for luxury travel is largely dependent on a growing consumer interest in all things luxury. The future growth in the luxury goods market is projected to expand at around 7.3 per cent per annum to 2010. But why do consumers buy luxury goods and services? According to PwC research, One in five UK consumers own luxury goods or accessories.⁵ The research suggests consumers are motivated to buy for five main reasons:

- 'Treat factor'
- Perceptions of luxury delivering better quality
- Brand image (especially important for younger consumers)
- Self indulgence
- 'Showing off'

All these are applicable to the hotel sector and provide a salutary lesson as the research warns, in an environment of growing consumer caution, luxury brand owners need to have a clear understanding of the motivations behind buying luxury goods in order to market their products and drive sales. This message was reiterated by those we spoke to in our research.

Demand drivers for luxury hotel accommodation

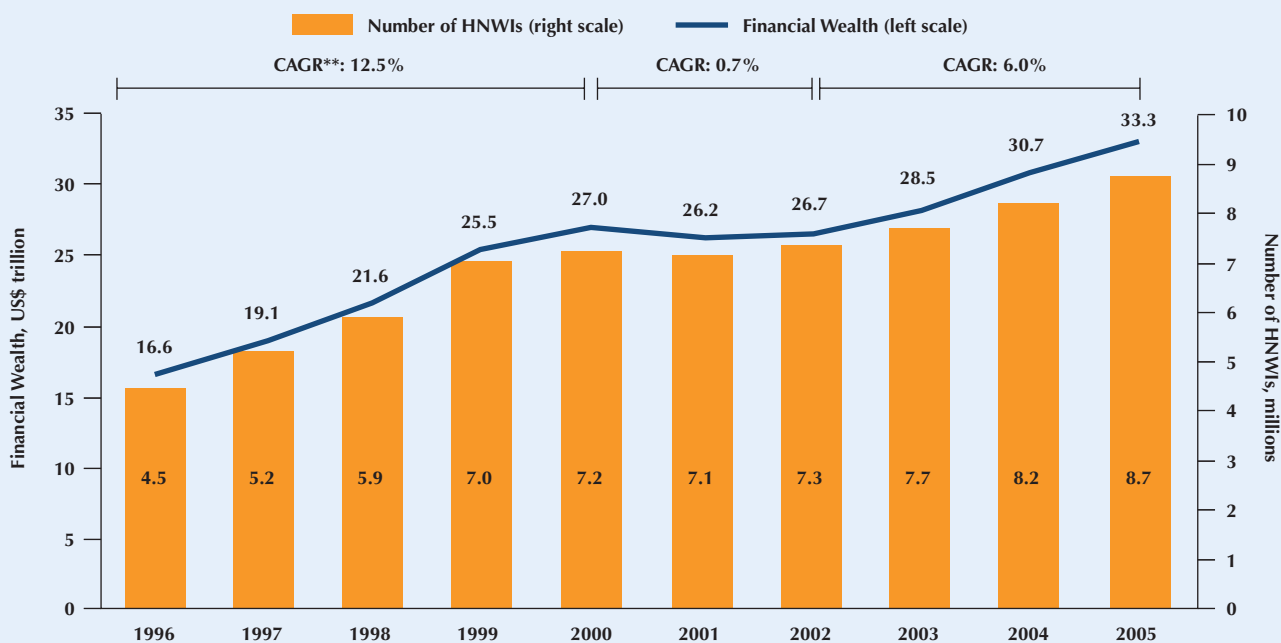
Clearly the demand drivers for luxury hotels varies with the type of property and is influenced by factors such as location and whether the hotel is an urban, resort or destination property, on the size, style, on-site facilities and so on. It would be rare for a luxury hotel to survive on one type of demand although some are led by corporate and some by leisure demand and these proportions may change.

Global travel volumes have demonstrated an ever upward trend and despite some geo-political shocks the sector has recovered quickly in the past, albeit inflicting considerable pain for hoteliers at the time. Economic growth and low cost carriers have enabled consumers to take more trips regularly and this is expected to continue. In the UK the number of travellers taking three or more trips doubled between 2000 and 2004.

Luxury travel is big business. A survey by ILTM, a luxury travel conference, showed that the highest spending 3 per cent of tourists accounted for 20 per cent of all tourism expenditure. The Travel and Leisure Strategy team at PricewaterhouseCoopers has undertaken research in the luxury travel market and estimates the sector is worth

⁵ Mark Hudson, PricewaterhouseCoopers UK retail and consumer leader. The Luxury survey was carried out for PwC in April 2007 by YouGov Plc. Total sample size was 2,238 adults. The survey was carried out online in April 2007 and the figures were been weighted and are representative of all GB adults (aged 18+)

Worldwide growth in number of high-net-worth individuals*, 1996-2005



* Defined as an individual holding more than US\$ 1 million in liquid investable assets. **CAGRs refer to numbers of HNWIs
Source: Merrill Lynch / Capgemini, World EWealth Report, 2005 and 2006.

around £4-5 billion in the UK alone. This is expected to grow by up to 9 per cent per annum to 2009, driven by the growth in travel in general (leisure and corporate) and by an increase in the number of High Net Worth Individuals (HNWI).

The number of High Net Worth Individuals is estimated at 8.7 million

The ability to pay luxury hotel room rates requires relatively high disposable incomes. The recent favourable economic environment has helped drive wealth creation and pushed more people into higher income brackets, supporting travel and hotel demand.

Global luxury travel market growth is influenced by the number of HNWI, in turn driven by global economic growth and the growth of travel in general. Both of these factors have been highly positive in recent years and are expected to remain so in the future. According to PricewaterhouseCoopers the number of HNWI globally has increased at around 8 per cent over the past decade and is expected to continue to grow going forwards.

The chart above shows this upward trend in wealth between 1996 and 2005, although the global recessionary pressures of mid-2000 to 2002 stalling wealth creation. In the UK since the late 1990s the HNWI population has experienced significant volatility following the fortunes of the financial markets, growing rapidly though since 2002. Those in the top income brackets (earning over £100,000 per annum) grew at almost 11 per cent over the last five years supporting strong growth in luxury travel. The worldwide number of ultra-HNWI or individuals who hold liquid assets in excess of \$30m is now estimated at around 85,000, with the highest concentration in North America, followed by Europe and Asia Pacific.

Growth has been fastest in Emerging Markets, reflecting economic growth patterns in these countries. In the past six years, the wealth of Emerging Markets' billionaires has increased from accounting for 11 per cent of global billionaires' wealth to 28 per cent, according to research by broker Bernstein. On a global scale, Emerging Markets are responsible for more than a third of the total luxury goods market growth compared with just 13.3 per cent between 1994 and 2000. Increased travel volumes from Emerging Markets are likely to fuel demand for luxury goods and services.

6 Luxury travel – trips that cost over £2,000 per head.

7 High Net Worth Individuals (HNWI): Individual owning at least \$1 million in liquid investable assets. Ultra-High Net Worth Individuals: Individual with financial assets in excess of \$30 million in liquid investable assets

Luxury hotel supply: key players and products

25 luxury operators account for 7 per cent of all hotel rooms in Europe⁸

As demand for luxury and business travel continues to grow so the battle among the hotel chains for these travellers is intensifying.

Table 1 lists the major luxury brands in Europe across a broad spectrum of luxury which we have grouped into three segments – the super luxury brands and operators, middle market luxury companies and the challengers, the more boutique/designer lifestyle luxury hotels.

Clearly no such listing can be fully accurate or comprehensive since the dividing line between luxury and the next level is subjective and often blurred. Even within

brands, some hotels may be regarded as luxury properties while others are not. Nevertheless bearing in mind these caveats, the table – which covers 25 ‘brands’, 21 companies, 481 properties with over 96,313 rooms. It reflects some major luxury companies in Europe and the fact that only a very few groups have significant numbers of luxury properties across the continent, although portfolios are growing.

There are around 1.4 million chain rooms in Europe meaning the 25 luxury operators account for almost 7 per cent of all rooms.

Super Luxury: At the very top end of the luxury sector, the very brightest jewels in Europe’s crown include some traditional trophy hotels such as the Four Seasons Georges V in Paris, the Savoy and Claridges in London and the Hotel Cipriani in Venice. Many of these ‘grandes dames’ are now part of chains but still operate under renowned and famous individual names. Although many

Table 1: 25 Luxury Hotel Companies Operating In Europe (end of 2007 by rooms)

Luxury Brands/collections	Operator	Luxury Hotels in Europe	Luxury Rooms in Europe
InterContinental*	InterContinental Hotel Group	64	20,641
Sheraton	Starwood Hotels & Resorts Worldwide	67	18,257
Sofitel	Accor	86	13,091
Le Meridien	Starwood Hotels & Resorts Worldwide	43	11,373
Kempinski Hotels & Resorts	Kempinski Hotels & Resorts	29	6,628
Luxury Collection	Starwood Hotels & Resorts Worldwide	37	5,489
Starhotels	Starhotels SpA	17	2,685
Ritz Carlton	Marriott International	9	2,493
Four Seasons Hotels and Resorts	Four Seasons Hotels and Resorts	14	2,450
Rocco Forte Collection	Rocco Forte Collection	12	1,748
Fairmont Hotels & Resorts	Fairmont Raffles Holdings International	5	1,520
Malmaison	Malmaison	11	1,210
Park Hyatt	Hyatt	7	1,200
Orient-Express Hotels	Orient-Express Hotels	11	1,084
Conrad Hotels	Hilton	4	1,082
Gran Melia	Sol Melia Hotels & Resorts	4	873
JJW Luxury Hotels & Resorts (includes recently acquired Eton Collection)	MBI International	9	750
Stein Hotels	Stein Hotel Group	17	650
Mandarin Oriental	Mandarin Oriental Hotel Group	4	564
Red Carnation	Red Carnation Collection	8	550
JW Marriott	Marriott International	2	465
Hotel du Vin	MWB	10	426
Regent Hotels	Rezidor Hotel Group	2	404
Grand Hyatt	Hyatt	1	342
Firmdale	Firmdale	8	338
	Total	481	96,313

Source: PricewaterhouseCoopers Research 2007. Where unbranded operator’s name has been used

* includes Africa and Middle East

⁸ We have taken 1.4 million chain rooms in Europe (Sourced from PricewaterhouseCoopers Hospitality Directions Europe edition 12 ‘The secret of Lifestyle Hotels success is simple: they are in touch with the new complex consumer’, August 2005) and assumed that new additions since then counterbalance losses and closures



Hotel Cipriani, The Doge's Suite

of the most famous luxury operators remain focused and lead from Asia, distinguished groups such as Four Seasons, Fairmont Hotels & Resorts - the largest luxury hotel company in North America - Ritz Carlton, Starwood, the RF Collection, Mandarin Oriental, Orient-Express and European group Kempinski, operate luxury properties in Europe and are particularly prominent in this category. Their point of differentiation is their reputation for consistently delivering on their promise of a luxurious product and staying experience. Many are refurbishing and innovating to stay in this segment and not become museum pieces.

Middle market luxury⁹: Many of the major international chains operating in Europe have hotels across a range of segments and brands including luxury. Among those groups operating at varying levels below the very top tier de-luxe operators referred to above, there are a number of brands with European portfolios. The largest of these include InterContinental and Accor's Sofitel. Conrad Hotels & Resorts represents the contemporary luxury tier within the Hilton family of brands. Starwood Hotels & Resort's has over 41,000 rooms in five brands including the Luxury Collection, Le Meridien, St Regis, Sheraton and soon in Europe, five lifestyle W hotels. Other brands operating in this category include Rezidor's Regent Hotels, two of Hyatt's brands (Park Hyatt and Grand Hyatt), Marriott International, Sheraton and Sol Melia's Gran Melia brand. All have luxury hotels or brands some of which also could be considered to reach the gold standard, for example InterContinental's flagship properties including the newly refurbished Park Lane Hotel.

Lifestyle, designer and boutique luxury: Smaller designer and lifestyle hotels are also active in the European luxury hotel market and in some markets luxury is polarising between traditional products and design-led hotels. Some are part of larger chains or part of larger fashion empires such as Ferragamo's Lungarno Hotels or Bulgari in Milan. A spokesperson for the Bulgari Hotel in Milan stresses that the hotel is not a design hotel but a pure, contemporary luxury hotel. Others include the Red Carnation Collection with hotels such as the Milestone; Stein's stylish hotels; Malmaison and Hotel de Vin. JWW Luxury Hotels & Resorts recently acquired the Eton Collection. Some of these, particularly the smaller boutiques, may represent the more affordable face of luxury, however this is not always the case.

Consortia: Between the jewels in the crown and the more standardised luxury branded properties, there are a large number of privately-owned and operated individual properties and small groups which are also competing for consumer's wealth. Many of these belong to one of the major sales, marketing and reservations organisations that represent luxury hotels and spas. For example, Leading Hotels of the World and Small Luxury Hotels of the World ("SLH"). SLH calls itself a luxury hotel brand with more than 400 independently owned hotels in nearly 70 countries. According to Hotels Magazines's Consortia 25 Survey, the focus for many consortia today is to provide more of a one stop shop on par with the leading chains.

Paul McManus CEO Leading Hotels of the World says *"As a global brand we are competing with the name brands in the luxury market for both hotel product and for consumers. On the hotel side, we've diversified into development, licensing, and other business activities... developers are getting more savvy and realise they can hook into a company like ours without having to put a luxury flag on it"*¹⁰

Spreading their wings: nine operators alone set to add 13,000 new rooms

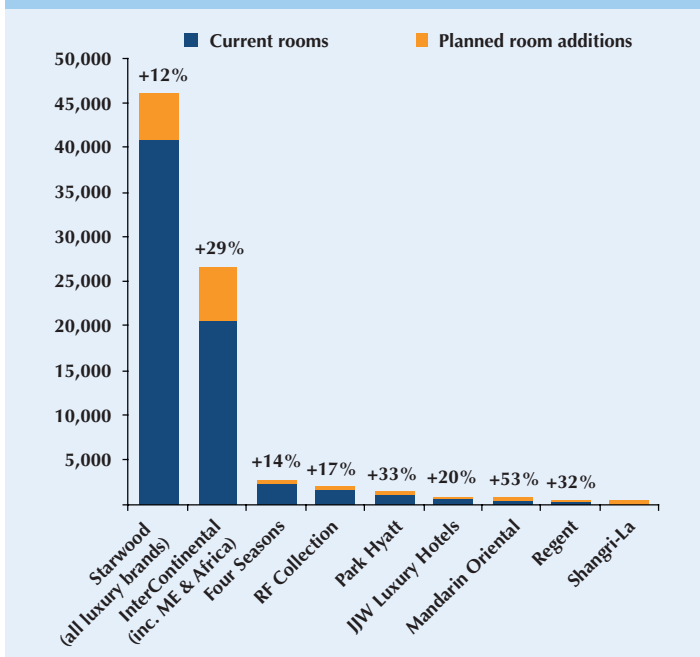
Several operators have strong development pipelines and some selected examples follow:

- Starwood plan around 18 new hotels and some 5,000 new luxury rooms in Europe (five W hotels, two Le Meridien, six Sheraton, two Luxury Collection)
- InterContinental have 19 hotels in the pipeline with around 6,000 rooms
- Shangri-La, controlled by Malaysian's richest person, Robert Kuok plan to have 500 rooms in Europe within the next five years, opening hotels in Vienna and Paris in 2009 and in London in Renzo Piano's London Bridge Tower in 2011

⁹ Luxury and upper upscale brands

¹⁰ Hotels'325 July 2007

Development plans of selected key luxury operators – rooms



- Mandarin Oriental Hotel Group has 16 hotels and resorts under development with two in Europe in Barcelona and Paris
- Regent introduced its first luxury hotel in 1970 and the group plans to double its luxury portfolio globally over the next two years. A Regent hotel is under development in Dubrovnik (130 rooms)
- JWJ Luxury Hotels & Resorts plan to open hotels in Vienna and Portugal
- Park Hyatt are opening two hotels in Istanbul and Casares in 2008
- The RF Collection will see new additions in Prague and Sicily opening next year.

Cristina Badenes, Research Analyst at Meridia Capital commented that in terms of future expansion, places like the Caribbean, for example, are experiencing fast growth and almost all the big luxury brands have projects there. The same applies to certain parts of Asia. Markets like Europe or the US are more mature and offer lower growth prospects.

Nevertheless, the chart above illustrates the proposed rooms additions (13,130) and hotels (57) for nine luxury hotel operators in Europe. If these supply additions are developed it would represent an approximate 20 per cent increase in these operators' existing portfolios. It would

also swell the luxury rooms total for the top 25 chains to over 480 hotels and over 96,000 rooms¹¹.

More diverse luxury products blending lifestyle and luxury

Companies are introducing new brands and brand extensions to target affluent travellers who want and are willing to pay for facilities, amenities and services above today's "five star" standards. Research and planning to determine how existing and new brands can appeal to targeted demographic markets including growing middle classes and the wealthy in China, India, parts of Asia and the Gen-X¹² and Millennials¹³ in North America and elsewhere. This will mean adopting a more modern approach to service and developing more contemporary hotels. Although the 20-year record pace in the number of new U.S. brand introductions is expected to slow in 2007, new brand introductions in Europe, Middle East and Africa as well as Asia-Pacific are expected to remain vibrant as companies expand their segmentation offerings. In illustration Accor recently announced the introduction of a new luxury brand Pullman. At the same time they are repositioning their Sofitel brand. Blackstone's recent acquisition of Hilton should now give Hilton 'the broader luxury identity it has lacked for years'.¹⁴

The table below shows some of these new luxury brands such as Hilton's Waldorf=Astoria Collection and Global Hyatt's Andaz brand, announced in April 2007. The Great Eastern Hotel in London will become an Andaz.

Table 2: New luxury global brand introductions in 2006 and to date in 2007

Waldorf=Astoria Collection (Hilton Hotels)
Pullman (Accor)
Nikki Beach Hotels (Nikki Beach Hotels & Resorts Worldwide)
Le Crillon (Starwood Capital)
Blue (Taj Hotels & Resorts)
Royal Tulip (Golden Tulip Hospitality)
Baccarat (Starwood Capital)
Andaz (Hyatt)
"1" (Starwood Capital)
SLS Hotels (SBE Entertainment Group)

Source: PricewaterhouseCoopers LLP from various sources

¹¹ This data can only be considered an approximation as it was gathered from a variety of sources. Development plans change and some may never be built, and there are also inconsistencies in some data, for example, InterContinental's totals include Middle East & Africa

¹² Generation X (Gen-X or Gen-Xers) is a term used to refer to individuals born between 1965 and 1976.

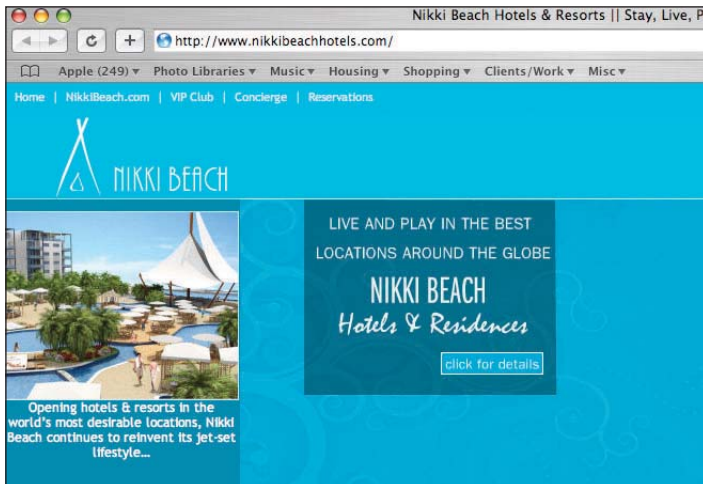
¹³ Millennials is a term used to refer to individuals born between 1977 and 1994.

¹⁴ Stephen Hennis, Hospitality, Hotels Magazine August 2007

“Our launch of Andaz is based on demand expressed by both consumers and developers for a product and experience that they have not found within the industry. This worldwide customer base is looking for fresh, uncomplicated luxury that is timeless and ‘gimmick’ free.”

According to Mark Hoplamazian, Global Hyatt Corporation President and CEO¹⁵

Starwood Capital Group announced it is developing a third luxury hotel brand, Baccarat Hotels and Resorts, which will leverage the brand name of the crystal manufacturer—in which Starwood Capital's controlled affiliate owns an 86 per cent interest. The first of these hotels, each of which will feature between 80 and 250 rooms and residences, is expected to open in Hawaii in 2010, but other locations are also under consideration in the Caribbean, Europe and Eastern Asia.



Marriott International recently announced a partnership with boutique hotelier Ian Schrager to develop a new lifestyle brand with a goal of at least 100 unique and individual hotels. The brand, to be created from a mix of new construction, conversions and renovations, will consist of hotels with about 150 to 200 rooms, and may include some gateway cities in Europe. Jetsetter luxury brand, Nikki Beach is to develop a hotel brand outside the US and plans to launch its first hotel venture in Marbella or Ibiza in 2009.¹⁶ According to its press release, the point of differentiation will be to fill a gap for fun and entertainment in the luxury sector.

Another new brand to be launched in 2008 is SLS Hotels, from Sam Nazarian (SBE Entertainment Group) who helped establish Starwood's W brand, and aims to bridge the gap between 4 star lifestyle boutique products and 5 star luxury properties.

“We want service to be informal, genuine, and relaxed, never pompous or stiff”

Attilio Marro, General Manager, the Bulgari, Milan



Consumers value spas

“Spas are still seen as one of the key ‘luxury experiences’ highly coveted by leisure and business travellers”

Paul Kerr, Joint Managing Director, Small Luxury Hotels of the World

Many luxury hotel companies are pursuing out-of-room revenue growth opportunities, including potential food and beverage outlets and spa growth opportunities in specific properties.

PricewaterhouseCoopers estimates that globally approximately 3.2 per cent of hotels have a spa component, with less than 4.0 per cent of the rooms supply attached to a spa. For upper-upscale, luxury and super-luxury hotels, around 35 per cent of the existing hotels have a spa. However, in the future hotels are expected to increasingly incorporate a spa component as illustrated by the growing number of hotels with spas in the global supply pipeline. PricewaterhouseCoopers estimates that approximately 5.0 per cent of the hotels in the pipeline have a spa component. See Table 3

The following table illustrates the geographic distribution of hotel projects with a spa component.

	% of Existing Hotels	% of Pipeline Projects
Americas	1.5	2.5
Europe, Middle East & Africa	3.5	5.0
Asia - Pacific	4.5	6.5
Global	3.2	4.7

Source: PricewaterhouseCoopers LLP (US firm) from various sources.

¹⁵ Travel Business Review 18 April 2007

¹⁶ Nikki Beach Press Release 31 January 2007

Increased awareness of spa experiences as rejuvenation exercises, diversification of spa products to include hiking, yoga, dance classes and other multi-generational products, increasing level of branding within the spa industry in hotels and increasing disposable incomes, are some of the factors that will drive the spa component growth in hotels in 2007.

Those we spoke to agreed that a spa is an essential facility and revenue generator, not just added as a differentiator. Rachel Denning from the Kiwi Collection commented that a significant trend in the luxury market at the moment is co-branding and that spas are an excellent way to achieve partnership with big brand names. Several stressed that spas can add value and ensure guest expenditure remains within the hotel.

Key message:

Spas are a key luxury experience and can add value

“Over the last 5 years, a full service spa has become vital in the success of a leisure hotel. City centre hotels that have added a spa facility have seen as much as a 20% increase in leisure business as a result.”

Paul Kerr, Joint Managing Director, *Small Luxury Hotels of the World*

“Spas are a very important way of getting incremental value”

“Piggy backing on the success of other products is an important extra revenue source”

Rachel Denning, Regional VP, *Kiwi Collection*

“The shift to the leisure segment can result in higher profitability in terms of their preference for larger rooms or suites and their use of other facilities such as spas, restaurants and bars. Today’s climate and volatility has resulted in a demand for luxurious stress-free destinations by leisure guests who are prepared to pay more.”

Michael Hobson, *Mandarin Oriental Group Director of Sales & Marketing*

Source: PricewaterhouseCoopers research 2007

Other facilities

Facilities provided depend on the business mix and opportunities at the property. For example, Nikki Beach Hotels plan to replace mini bars with premium alcohol and cigar cabinets in their new hotel concept.

Co-branding on the up

The Rezidor Hotel Company also stressed the growing trend towards co-branding in all areas between hotels, restaurants, fashion houses and other ‘cultural brands’.

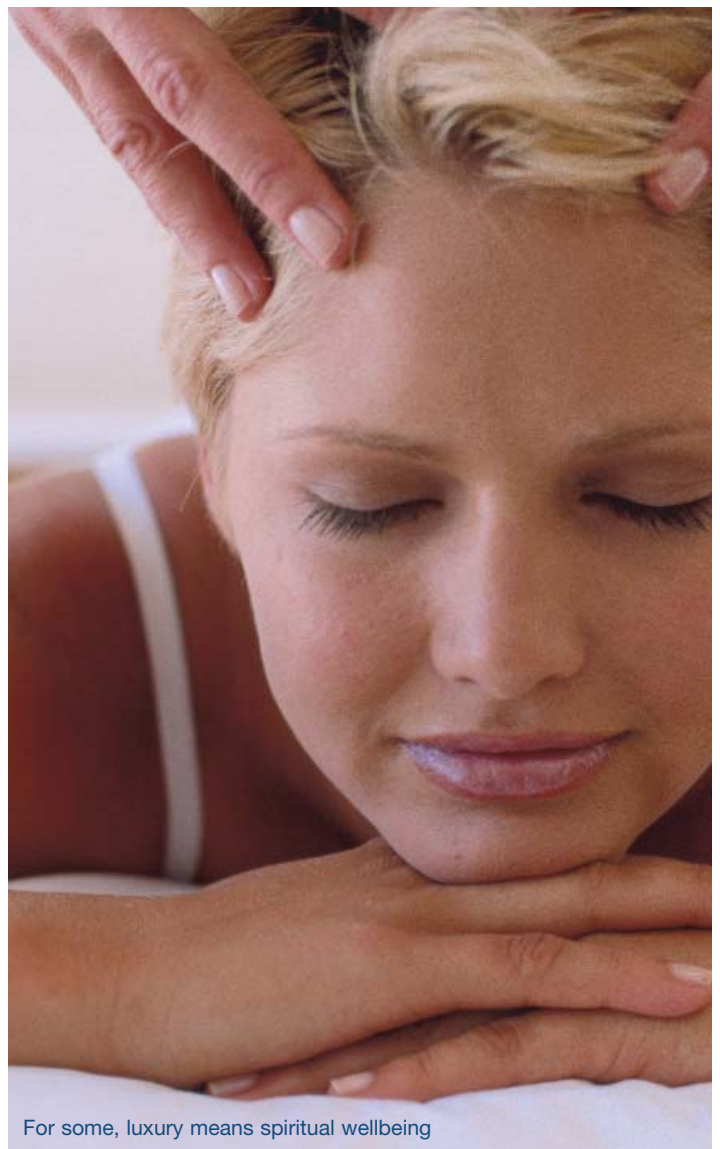
Key message:

Hotels need a clear point of differentiation

“Many hospitality properties are looking into stores and their own product lines. Others are looking outside of the property for ideas to differentiate themselves. Some hotels are targeting the child/teen market with ideas like the teen concierge at the Four Seasons Hyde Park, London “

Erik Haugen, Chief Executive, *the Kiwi Collection*

Source: PricewaterhouseCoopers research 2007



For some, luxury means spiritual wellbeing

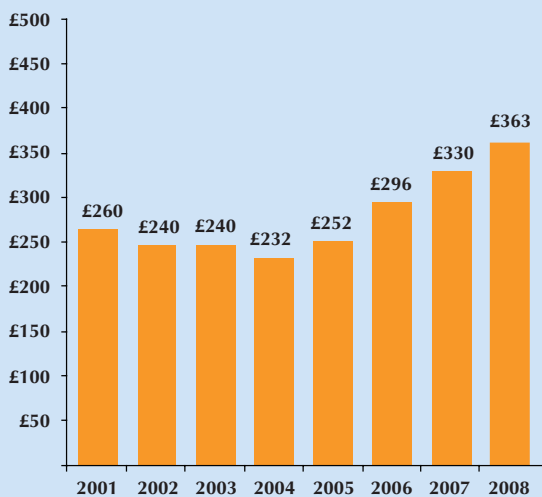
Market outlook

Taking London as an example, the market forecast appears positive for this sector.

Average room rates at London's luxury hotels could pass £360 by 2008

London has one of the most profitable hotel markets in the world. High barriers to entry include the cost of land, building and planning restrictions. Supply shortages and strong demand from the financial services sector as well as London's role as a major tourist destination have allowed hoteliers to raise rates steeply in recent years. With average room rates at the high levels shown below it is easy to see why major luxury chains want a presence in London, despite the costs of getting that presence.

London's luxury hotel room rates could pass £360 in 2008

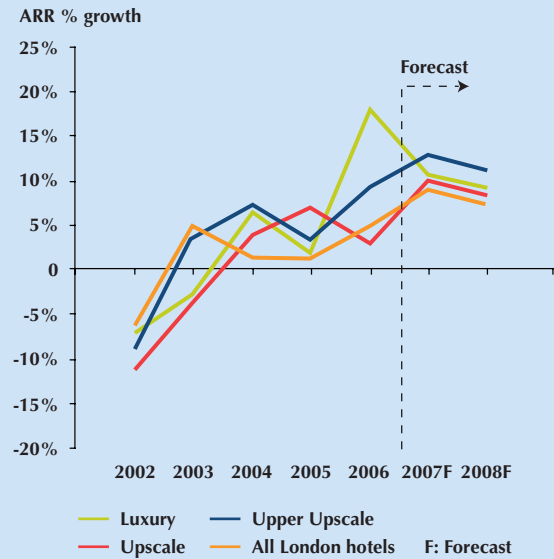


London has a high concentration of luxury operators including brands such as St Regis The Lanesborough, Faimont the Savoy, and Four Seasons. Using data from the Bench and STR, PwC analysed a sample of 45 luxury hotels with 4,590 luxury rooms. With around 83,400 hotel rooms in London in all categories this would mean the super-luxury/de-luxe segment comprised around 5 per cent of London's room supply.¹⁷ In addition we compared past and future performance of the luxury sector with upper upscale hotels in the capital (205 hotels and 28,045 rooms) and also for general comparison with upscale hotels (191 hotels and 22,811 rooms). Drawing on historic performance we then forecast likely future performance.

London's luxury hotels saw average room rate gains of over 17 per cent last year taking average rates to almost £300. We anticipate room rate growth of 11.8 per cent this year and, despite a slowdown in rate gains, growth is likely to reach 9.9 per cent in 2008 reaching a record £363.24 in 2008. See chart and graphs above.

¹⁷ 83,389 rooms total sourced from VisitLondon census 2006

London's luxury and upper upscale hotels power ahead Average room rate growth 2002 to 2008



Source: Forecast: PricewaterhouseCoopers August 2007

Benchmarking Data: The Bench/STR August 2007

If we compare this with other segments in London we can see clearly that luxury hotels room rate growth last year of around 17.4 per cent was almost twice that of the upper upscale segment, at 8.9 per cent, and five times the rate for upscale hotels.

Although occupancies in the luxury category are a little lower than upper upscale and upscale categories they remain high at around 76 per cent last year. However only marginal occupancy growth is expected across all categories this year and in 2008 as London is effectively "full".

This all adds up to extraordinary revenue per available room rate growth (RevPAR) of 13.7 per cent this year, on top of 21.7 per cent growth in 2006. This is expected to slow a little to around 10.8 per cent in 2008 taking RevPAR to £280.39. This compares to RevPAR of £132.50 in the upper upscale sector and £89.86 in the upscale sector.

New luxury operators in London

Despite the challenges of getting a toehold in London, over the next four years, from 2007 to 2011, VisitLondon estimate that around 4,000 luxury rooms will open. The largest schemes under construction include:

- Silken Hotel, on the Strand
- Sofitel, Terminal 5 Heathrow
- Renaissance, St Pancras station
- Park Plaza, at Waterloo

Some projects that may get built include:

- London Bridge Tower, Shangri-La
- In & Out Club Piccadilly, (No operator announced yet, development by Buckingham Securities)
- Beetham Tower, Jumeirah
- Bow Street Magistrate Court, Edward Holdings
- Metropole & Regent St Quadrant, Crown Estates



Grand Hotel Europe, Rossi's Restaurant

Potential risks and challenges

Keeping up appearances

Bringing older luxury properties into the 21st century so they can compete with more contemporary hotels means a high capital investment and high expenditure on quality furniture fittings and equipment. Hotels may need to refresh properties perhaps as much as every six months. Some of the very best contemporary hotels, once accused of minimalist service as well as décor, have proved they can now compete in terms of high service levels too.

Some of London's oldest and grandest hotels are ensuring they do not become museums and are closing for refits and modernisation. Fairmont Hotels & Resorts is to carry out a £100 million restoration of The Savoy, including upgrades to suites overlooking the Thames, renovation of guestrooms, corridors, public areas and the reopening of the River Restaurant. The hotel is set to stop taking reservations in December 2007 reopening in 2009. Claridge's, The Berkeley and The Connaught Hotels are also overhauling their identities as part of a major investment by parent company Maybourne Hotel Group.¹⁸ The first fresh identity will be for the 110-year-old Connaught Hotel, to coincide with a £60m refurbishment that began at the end of March. As part of the refit, a wing

will be built housing a spa and swimming pool as well as a grass roof to help reduce the hotel's carbon footprint. The hotel will re-open in the autumn.

Elsewhere in Europe a similar story is unfolding as the Villa Magna Park Hyatt in Madrid is closed till 2008 while the Spanish architect and designer Thomas Urquijo transforms the hotel's design concept. Orient-Express Hotels have been busy renovating the Grand Hotel Europe and introducing innovative improvements at the Hotel Cipriani in Venice, reputedly Italy's most expensive hotel. New apartments have been built in historic adjoining buildings, furnished authentically and allowing the hotel to compete on the world stage delivering privacy, security and a sense of place.

Could rising building costs threaten some projects?

The financial characteristics of a luxury hotel are partly shaped by the definition of luxury itself and despite variant business models discussed earlier; a general characteristic of a luxury hotel is that, in addition to offering high quality rooms, fittings and food, it will also be service-intensive. This means that the typical capital investment per room is high and that staff-to-guest ratios also tend to be high.



In recent years the cost of construction has been rising. In London construction costs have risen 14 per cent in two years, according to Davis Langdon, and are set to rise another 14 per cent in the next two years.¹⁹ Although this is of most concern for large infrastructural projects and is partly to do with rising prices for materials because of competition from China and India, there are implications for hotels too.

Today, it is often only a broader mixed use development, often with residential elements, that can help underwrite the cost of developing luxury hotels, given the high cost of land in the prime locations luxury hotels require and the high quality of fixtures and fittings as well as high service levels, such as twice a day maid service. Such high costs may place the cost of a hotel room beyond what many consumers are prepared to pay, especially in a downturn when corporate travel budgets are squeezed.

Operating cost profile

Scale is influential in determining the operating cost profile; as the size increases, a greater range of services and ancillary facilities tend to be added. Many of these, such as spas for example, are labour-intensive, and hence larger properties tend to have higher staffing requirements - and thus higher short-term marginal costs - than smaller properties. In operating terms, the cost base of a luxury

hotel property is likely to be high, and also relatively inflexible. When times are hard, short-term cost reductions are difficult to achieve without devaluing the brand and threatening the hotel's status as a luxury property. More flexible contemporary hotels such as the smaller boutiques may have a more flexible business model with less emphasis on public spaces and lower staff ratios.

Market risks

On the revenue side, room rate is king. Despite high quality F&B and the considerable ancillary facilities that are on offer, room revenue could account for as much as 75 per cent of total revenue and in excess of 50 per cent of profits (although, this varies by location and type of property). Luxury hotels and spa/wellness resorts, for example, depend more on ancillary sales. Again, scale is important.

Against the backdrop of the current good times, running a luxury hotel within a typical business cycle can be a roller coaster - the drop can be visceral, but the rise on the other side can, as now, be exhilarating. Luxury hotels are the most volatile of all segments of the hotel industry. They are the first to take a dive when times are bad, but are susceptible to very rapid recovery when times are good, as we have seen recently.

¹⁹ Financial Times, August 2007, Rising building costs threaten projects

Conclusion

Although Europe's luxury hotel sector is booming it faces a number of challenges. No player in this space can afford to relax in an environment where the rules are changing and individuality and experience rule. Luxury brand owners need to have a clear understanding of the motivations behind both business and leisure guests' purchase of luxury hotel rooms and services and precisely what they value and will pay for.

The meaning of luxury is likely to be stretched further as the marketplace becomes more crowded with new openings – over 13,000 rooms from nine operators alone – new and repositioned brands and newly refurbished hotels joining the scene. Marco Pierre White once wrote that the future for eating out will be affordable glamour. The evidence shows that consumers are still hungry for affordable glamour and luxury in the hotels sector. However, as in other consumer facing industries, increasing market polarisation around value, may mean that affordable and super luxury products prosper most, while the less differentiated middle luxury segment is squeezed hardest.

Consumer and investor caution as equity and debt markets suffer could also challenge this sector, but in the end, affluent travellers will always demand the best despite economic cycles while owners will continue to seek strong luxury brands that can deliver a high return on capital and create real estate value.

Key message:

Luxury hotels are a growth market

"The main trend is that developers, owners and customers alike still seem to have a huge interest in the luxury sector and this doesn't look like tailing off anytime soon".

Paul James, Regional Director of Sales & Marketing, North West Europe, *Starwood Hotels & Resorts*.

Source: PricewaterhouseCoopers research 2007

Research base

We acknowledge with thanks the contribution to the article made by the following with whom telephone or face-to-face discussions were held or who submitted written comments to us.

Ritz Carlton www.ritzcarlton.com	Sergey Loginov
Jumeirah www.jumeirah.com	Anne Bleeker
Starwood Hotels & Resorts www.starwood.com	Paul James
The Rezidor Hotel Group www.rezidor.com/	Puneet Chhatwal
Mandarin Oriental Group www.mandarinoriental.com	Michael Hobson
Shangri-La Hotels www.shangri-la.com	Joanne Watkins
Meridia Capital www.meridiacapital.com	Cristina Badenes
Brown's Hotel (Rocco Forte Collection) www.roccofortecollection.com	Stuart Johnston
Splendia Luxury & Character Hotels www.splendia.com	Regis Perruchot
Small Luxury Hotels of the World www.slh.com	Paul Kerr
Kiwi Collection www.kiwicollection.com	Erik Haugen and Rachel Denning



Contacts:

To discuss any of the issues in this article, please contact:



Robert Milburn
UK Hospitality & Leisure Leader
+44(0) 20 7212 4784
robert.j.milburn@uk.pwc.com



Liz Hall
Head of Research – Hospitality & Leisure
and Editor Hospitality Directions Europe
+44(0) 20 7213 4995
liz.hall@uk.pwc.com

For further hospitality & leisure research and news visit www.pwc.com/hospitalitydirections

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