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Global Hospitality Insights

Mixed-Use



The United States



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With developer confidence buoyed by the strong recovery in the lodging market, and extremely active capital markets, the construction pipeline is accelerating. While freestanding developments in the select service and midscale segments are increasing in markets across the US, mixed-use projects have become the norm to the development of upscale and luxury properties, particularly in major urban and resort markets. Based on data provided by *Lodging Econometrics*, 29 mixed-use resorts are currently under construction, emphasizing the significance of mixed-use developments for resort properties alone.¹ *Lodging Econometrics* projects 23 and 21 new mixed-use resorts to open in 2007 and 2008, respectively.² These resort developments feature various unit types, including hotel, condominium, private residences, timeshare and fractional. Interestingly in 2005 and 2006, hotel rooms made up 50 percent of the unit mix. In 2007 and 2008, the relative share of hotel rooms is expected to decline to approximately a third as condominium and private residences are anticipated to have a higher share in the overall unit mix.³

Anchored by the recent boom of condo-hotel development, mixed-use projects with a hotel component are progressively establishing themselves as a legitimate subcategory within hospitality and real estate. Our experience has shown that the process of developing a successful mixed-use project is more than just the collective development of a group of buildings. A hybrid between various hospitality, residential and often commercial spaces is a carefully calculated equation that must have the right balance of functionality, economic viability, and lifestyle.

While synergies of the mixed-use components appeal to guests, it also presents opportunity for developers to improve project feasibility. As the cost of construction and materials

Mixed-Use: Key Questions

- What impact does branding have on the development's overall value?
- What role do design and layout play in the project's success?
- How do you determine whether a location makes sense for a mixed-use project?
- How can the project be seamlessly integrated with its surrounding area?
- Is management qualified to operate all uses?
- How can synergies among uses maximize returns?
- Are revenues and expenses fairly allocated to all stakeholders?

¹ Lodging Econometrics: "Mixed Use Resort Construction Pipeline Forecast." December 2006.

² Ibid.

³ Ibid.



Asia-Pacific/Australia

continues to rise and the availability of land declines, developers are looking to mixed-use developments to support the viability of ground-up developments. Developers are integrating hospitality concepts such as timeshare, condo-hotel, private residences, and fractional ownership. Through effective pre-sale efforts, less of the developers' own equity is required, mitigating financial risk. Financing from lenders is more easily obtainable for a mixed-use development and looked upon more favorably than stand-alone hotels. Developers are commonly required under city mandates to include a certain number of hotel rooms as part of large mixed-use projects, and in an increasing number of instances, a hotel component is being viewed extremely favorably by the lending community, wary of overextending in a particular asset class such as for-sale residences.

From a developer's perspective, proximity to retail, restaurants, and offices provides a wider selection of choices and a built-in source of demand. Our experience has shown that including the right type of hotel in a residential mixed-use can help the developer increase the price of condominiums, obtaining a premium over a purely residential project. We've found that mixed-use projects appeal to potential home-owners because of the amenities and service offerings, and often the value of the real estate increases with the association of a branded hotel component. Homeowners receive added amenities through the hotel component as well as the confidence that they will have professional management and that certain brand standards will be met.

While there are many benefits of marrying a hotel into the progressively larger mixed-use "lifestyle" developments, functions such as legal, accounting and operations could be complex as resources between components are shared. Different owners in the various components, and developers, have diverse and sometimes conflicting needs and goals in a mixed-use property. Additionally, we've found that design is an important factor. Separate

Experience shows that barriers to entry remain high in most markets and the hotel development pipeline is light. With the exception of Melbourne, major markets such as Sydney, Brisbane, and Perth, have very limited development pipelines. We have found that, similar to other geographies, stand-alone hotel developments are still generally considered to have a higher risk profile than other real estate asset classes. In a few instances, developers are pairing hotels with other real estate uses to mitigate some of the risk. Diverging from the global trend supporting various scales of mixed-use development, the majority of major cities in Australia are exhibiting limited, if any, development of mixed-use projects and stand-alone

structures, multiple entrances, and utilities are challenges that architects face when designing a multi-use complex.

Throughout the US, hotel companies are focusing on the mixed-use trend as a way to strengthen and increase brand recognition, often through the branded residential component. Many of the well-known lodging companies are increasingly involved in the mixed-use trend. Most of the major gaming companies are also rolling with the mixed-use trend. All of the projects for Carlson's Regent Hotel brand in the US are currently mixed-use developments. Marriott has also been involved in multiple mixed-use projects, particularly with respect to its Ritz Carlton Residences. Kimpton Hotel & Restaurant Group, LLC has created a separate brand to develop and manage projects that merge the traditional hotel with residential components. ■

hotels. Most developments in the hospitality pipeline are serviced apartments. However, hotel investment values are considered lower than construction and replacement costs in Australia.

One of the major drivers of mixed-use development is public agency planning policies. For example, in the current supply life cycle, Melbourne is one of the only major Australian markets that has demonstrated some propensity towards the trend in mixed-use development – due in part to the Victorian government's intent to invest in tourism following the Commonwealth Games in March 2006. Included in the government's plan is the extension of the Melbourne Convention Centre, which will feature a hotel, restaurants, retail, and parking facilities, and is scheduled to be completed in 2009. The US\$781 million development is anticipated to include a five-star, Hilton-flagged hotel, which will be connected to the expanded convention center by a pedestrian bridge. It will also include a 190,000 square foot (17,100 square meters) office and residential tower, as well as a riverfront promenade of lifestyle retail. Conservative projections anticipate Melbourne's hotel room supply increasing to approximately 12,469 hotel rooms from 11,200 rooms by 2008.

The first phase of the Sydney central business district's most famous mixed-use development, World Square, opened in 2005. World Square contains retail and restaurants, major office buildings, residential apartments, serviced apartments, and underground parking spaces. World Tower, the residential tower contained within World Square, is the tallest residential tower in Sydney. World Square is also serviced by a monorail stop with its own station contained within the World Square complex. ■



Western Europe

Economic recovery in Western Europe and the comparative strength of the Euro have fueled real estate investments from a widening investor base such as private equity firms and real estate investment trusts (REITs). We have found that strong hotel performance growth in Western Europe is causing increased interest in placing hotels in mixed-use complexes, where they often perform as anchor tenants. Operators looking to expand their European presence are eager to place their brands as a component of mixed-use developments, as these developments usually have premier locations near city centers. Newly developed mixed-use facilities in Europe are increasingly becoming environmentally-friendly – an emerging design trend. With the establishment of mixed-use facilities, European cities are hoping to modernize and establish lifestyle centers.

The “1” Hotel and Residences brand has recently been announced. It is expected that a historic property in Paris, France will be renovated to launch the new brand. “1” will combine luxury accommodations, residences, restaurants, and spa facilities under one roof. This mixed-use facility is anticipated to meet the green building standards of the Leadership in Energy and Environmental Design.¹ Barcelona’s Poblenou district, also known as 22@, is currently undergoing an urban renewal, and a mixed-use facility is under development there. The project is anticipated to become a design-conscious as well as an environmentally-sustainable building. On Barcelona’s Paseo de Gracia, Mandarin Oriental’s first hotel in Spain, the 144-room Mandarin Oriental, Barcelona, is anticipated to open in late 2007 with retail tenants on the ground floor of a redeveloped mid-20th century building.

FrankfurtHochVier (“FHV”) is a mixed-use facility anticipated to open in 2008 in Frankfurt, Germany. Through an innovative use of the 187,300 square foot (16,860 square meters) site, FHV will provide 1,238,000 square feet (111,420 square meters) of floor space that is anticipated to contain retail, office, dining facilities, hotel, and a 15,000 square foot (1,350 square meters) multi-function hall. The unnamed hotel is anticipated to be a four-star, 284-room hotel with its own conference and dining facilities. FHV’s underground parking is anticipated to provide space for 1,400 vehicles. FHV is expected to change the image of Frankfurt by adding modern leisure and retail facilities, eventually becoming Frankfurt’s city center.

Numerous self-contained mixed-use facilities are anticipated to open in the United Kingdom as well. Scheduled to open in 2009, the 66-story London Bridge Tower is a mixed-use facility expected to be the most environmentally-friendly building in London. The London Bridge Tower is likely to contain office, museum, residential, dining, and shopping facilities, and an unnamed five-star 200-room hotel. In Greater Manchester, the City of Salford Stadium, a mixed-use sports facility, is anticipated to open in late 2008 and contain a 20,000-seat rugby stadium for the Salford City Reds, as well as museum, retail, and office components and a 208-room hotel with conference facilities. In Leeds, the 47-story mixed-use facility at Criterion Place is expected to begin construction in 2008 and will contain luxury residential, office, retail, and casino components and a 186-room hotel. This mixed-use facility is anticipated to serve as a city center upon completion.

The United Kingdom is also looking to the development of several large mixed-use complexes that cover large parcels of land. Paddington Waterside is an 80-acre mixed-use complex in central London. In addition to office, healthcare, residential, and leisure facilities, Paddington Waterside houses the Hilton London Metropole and Hilton London Paddington. Brindleyplace in Birmingham is a 17-acre city center canal-side mixed-use complex being developed in several phases. Brindleyplace is anticipated to contain 1,100,000 square feet (99,000 square meters) of office, 330,000 square feet (29,700 square meters) of retail, restaurant, and leisure facilities, apartment buildings, and a hotel upon its completion. In Newport, South Wales, two expansive mixed-use complexes are being constructed in anticipation of the 2010 Ryder Cup Golf Tournament. Friar’s Walk, a mixed-use complex containing retail, restaurants, multi-screen movie theater, residential, health club, and a 100-room hotel is anticipated to open in 2010 at the existing site of John Frost Square. The existing Cambrian Centre, also located in Newport, is expected to be transformed to a 31-story mixed-use facility renamed City Spires by 2010. City Spires will potentially contain residential, office, retail, and a 120-room hotel.

We’ve found that mixed-use facilities in urban cities of Western Europe are becoming prevalent and are developed to become city centers to accommodate a shift towards fast-paced lifestyles. Hotel facilities within mixed-use complexes create a symbiotic relationship between the mixed-use facility owner and hotel operator. These hotels are pivotal to owners due to the hotels’ brand and creation of a variety among tenants to spread out risk. In exchange, hotel operators expand their presence in urban city centers and hope to demand high average daily rates. ■

¹ The Leadership in Energy and Environmental Design (LEED) Green Building Rating System is the nationally accepted benchmark for design, construction, and operation of high performance green buildings. LEED promotes a whole-building approach to sustainability by recognizing performance in five key areas of human and environmental health: sustainable site development, water savings, energy efficiency, materials selection and indoor environmental quality.

Latin America/Caribbean

The trend towards hybrid real estate investments has been driven globally by changing demographics and evolving economic realities. Our experience has demonstrated that for developers, mixed-use projects have offered financing opportunities generally not available to a pure hotel development; also, they serve to mitigate overall risk through a diversified mix of asset types and related cash flows (i.e., across leases, operating cash flow, and sales proceeds). We've also found that for users, they offer a unique synergy by offering multiple real estate products such as retail, office, hotel, and residential so that one can work, shop, exercise, dine, and relax within close proximity – in a time-starved world, convenience is a key selling point.

In the Caribbean and Latin American region, where financial risk is greater than in more mature markets (issues include weather, political stability, and currency risk, among others), our experience has shown that getting a resort built, particularly at the upper end, has necessitated a mixed-use approach to mitigate risk across various asset classes and make financing a reality. Concurrent with the worldwide boom in second-home vacation real estate, the Caribbean and Latin American regions are experiencing rapid growth in this sector, the most prominent examples being anchored by hotels as the preferred vehicles to deliver a world-class hospitality experience. Through pre-sales of residential products (condominiums, villas, lots, townhomes) and hybrids (condominium-hotel units purchased then placed into a rental program, fractional vacation ownership), the development benefits from a cash infusion up front, reducing the need for long-term equity usually required for a resort investment. In turn, the

users of the residential component contribute to the success of the lodging operation through utilization of its revenue-producing amenities such as golf, spa services, and food & beverage.

From a total returns perspective, lodging is often the weakest link, making up a relatively minor piece of the pie over the initial investment period. Ironically, however, it is the most crucial part to the success of the development. The hotel experience sets the positioning for all that follows: it sets the tone for quality and thereby contributes to the premiums that the residential offerings garner among buyers. Upper-end brands in particular can contribute 15-40 percent over unaffiliated, highly-amenitized comparable real estate in the region.

A key design trend in the region includes a move to greater outdoor spaces, often upwards of 30 percent of the total space. Balconies and terraces with infinity or plunge pools, Jacuzzis, and large seating and entertainment areas contribute to the popularity of the outdoor experience that lures buyers to this region. Amanara in Providenciales is an example of this trend, with villa units consisting of structures built around a central water feature, extensive outdoor private balconies in each unit, and an open-air restaurant and bar. Product trends include a move towards condominium-hotels with a retained percentage of dedicated, developer-owned units.

With over 30 resort-anchored mixed-use resorts currently in the pipeline, the next several years will see increased competition among land-use types and ultimately, greater options for travelers. ■

Middle East

Modern mixed-use developments in the Middle East began in the emirate of Dubai, United Arab Emirates, during the late 1990s and have rapidly expanded throughout the region since. Many of the original mixed-use developments primarily featured a residential and lodging emphasis, such as the Palm Jumeirah and Dubai Marina. However, as the population and economy continued to strengthen, office, retail, and leisure components were added to many of the announced projects.

The government of Dubai has been very successful in establishing mega mixed-use developments that feature a primary business emphasis or theme, such as Dubai Media City, Internet City, Healthcare City and Dubai International Financial Center, but contain each of the real estate components. Each of the aforementioned developments were granted free zone status, giving them more flexibility in what kind of components they can include. In addition, the government has used a series of incentives to entice international companies and investors to invest in the projects, which in turn, draws both residents and visitors to the projects.

Since 2000, Dubai has announced and begun construction on many new mega mixed-use developments across the emirate, with each one attempting to “outdo” the last. The recently announced Bawadi project, when completed, will feature the largest concentration of hotels in the world and is anticipated to include the Asia hotel, which will be the world's largest hotel.

As the success of many of the Dubai projects has become apparent, countries throughout the Middle East and North Africa have announced similar mixed-use developments in their respective countries, while the pri-

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India

Despite a limited number of precedents, mixed-use development is a trend that is gaining significant momentum in India.

Retail, serviced apartments, and hotels are the most common components among the proposed mixed-use developments. Multiplexes are often included as part of the retail developments to generate additional foot traffic for the retail areas.

Our experience has shown that a pure retail format may not permit optimum use of the total available developable area because retail rents and occupancies tend to decline on higher floors. A mix of retail and hotel components is favored because hotels typically do not experience the same inverse relationship between floor level and average daily room rate. The typical format emerging is one where the retail component is situated on the first two to three levels, while the hotel component has a lobby area on the first level and guest rooms, food and beverage outlets, and facilities on higher levels, above the retail areas. This leads to better space utilization, which is important, especially as the land prices continue to rise. It also creates benefits of diversification by combining asset classes that have different life cycles. This concept of mixed-use development is found in larger metropolitan areas as well as smaller, rural cities.

Some of the mixed-use developments that already exist include the Oberoi in Mumbai and the Leela Palace Kempinski in Bangalore, both of which have a significant retail component along with the hotel component. One of the key differences between these earlier developments and projects that are currently in the pipeline is that while the earlier developments had some degree of horizontal separation between the hotel and the non-hospitality components, respectively, current projects follow a different concept with all components sharing the same vertical structure. This design enables developers to maximize returns given the increasing land prices.

Another important concept that is emerging is the convention center with a hotel component. One example is the proposed development by Reliance of the convention center in Mumbai, with commercial office space, hotel, and retail components, among others. Based on our experience, it seems that in the past, large convention centers tended to be developed by the Indian Government and government-related agencies. Now, however, they are being developed by private developers on land leased or auctioned by government authorities, as well as through public-private partnerships. Components other than the convention center are required from a demand perspective and also probably from a cross-subsidization perspective.

The mix of residential and hotel components is not that prevalent, even though some projects are currently in the pipeline, such as a high-end development in Delhi which will feature residential units in conjunction with a hotel. This concept is more likely to be compatible with a premium positioning, especially in prime residential areas in major cities or leisure destinations – specifically beach locations and golfing destinations. With the high development costs and longer ramp-up period associated with hotel developments, a residential component eases the cash flows substantially as customer advances fund the residential construction and allow for a surplus to be available earlier in the development cycle. With the growth of global luxury hospitality brands in India, this concept also appears likely to impact mixed-use developments.

Although still in its infancy, the concept of mixed-use developments seems to be here to stay. It will likely go through a process of evolution, but demand dynamics and investor returns present a strong case for the increasing popularity of this concept. ■

Middle East (continued from pg. 4)

Many developers from Dubai have also expanded to develop similar projects in countries such as Saudi Arabia, Qatar, Egypt, Libya, Algeria, Morocco, Lebanon, Tunisia, Syria, Oman, India, Turkey, Pakistan, and Bahrain.

As many of the developments throughout the region are not located in urban centers and are usually developed on vacant land away from the city center, we've found that the current mixed-use type of development also provides a much needed functional method of controlling and managing the rapid population and economic growth throughout the region. Many of the most recent projects such as Dubailand, Dubai Festival City, Dubai Waterfront, and Burj Dubai/Business Bay, are literally cities within cities. They are anticipated to feature a number of mixed-use components, including residential, commercial, retail, lodging, and leisure, and are designed to be live, work, and play communities. Two of the most recently announced projects, Dubai Lagoons and Cultural Village, appear to be differentiating themselves by focusing on theming the developments and adding a much needed cultural aspect, such as opera houses, symphonies, and arts centers, which is anticipated to service the need of the changing economy. ■

Russia

The Russian real estate market has evolved from the most basic products of individual office and retail space to now include the more complex formats of mixed-use developments as the newest real estate products enter the market. Hospitality components are prominent in the mix of uses as the hotel market in Russia goes through a major transformation.

Mixed-use projects being introduced in Moscow include:

- the Federation Tower, soon to be Europe's tallest building, which contains space for offices, a Park Hyatt hotel, serviced apartments, and permanent residences,
- urban low-rise projects, usually office, retail, and entertainment, and
- suburban developments with luxury homes, sports facilities, and recreational amenities.

Developers in Russia began with a simple mix of retail and office spaces, and have progressed to large "city within a city" complexes aimed to provide comfortable conditions for living, working, recreation and entertainment. Hospitality components are included in both the urban and suburban type developments. The original urban mixed-use development of 1991 to 1993 was Park Place, a mid-rise condominium style complex containing primarily residential apartments with an accompanying office block and supporting retail space. It was designed to provide a secure residential choice for international business leaders and their families working in the "new" Russia of the 1990s. This project has consistently demonstrated the value of the mixed-use concept.

The first suburban mixed-use development, built northwest from Moscow's city center in the early 1990s, contained a hospitality component. The complex features a golf course and club, swimming lake with beach, rental cottages, and a major health spa and fitness complex. One major retail developer plans to build malls in 12 of Russia's major cities, each with 214,000 square feet (19,260 square meters) of retail space,



and is building a hotel within each project. Four of these developments are already open, with the remaining developments either under construction or in the final planning stages.

The most prominent office-hotel mix in Moscow is the Riverside Towers complex, containing 866,500 square feet (80,000 square meters) of office space, a major performing arts theater facility, and a 350-room hotel. Completed in 1996, the developer now benefits from average occupancy of more than 80 percent in the hotel at an approximate US\$300 average daily rate.

In Moscow, the local authorities are strongly encouraging hotel development which is anticipated to stimulate additional mixed-use developments. The lack of sufficient visitor housing was one reason the city was not selected to host a future Olympic Games event, and the city's administration is determined to correct this deficiency. The city has offered to grant land sites at significant discounts to abate property taxes and even to subsidize construction period interest costs to encourage hospitality and mixed-use developments. These incentives are anticipated to act as a catalyst for the development of additional hotels combined with other types of commercial development. ■

Ernst & Young services for the Hospitality Industry.

Ernst & Young is at the forefront of advising developers, investors and lenders involved in mixed-use projects. We have analyzed multiple projects during the past several years that have allowed for a better understanding of cash flows to various stakeholders, highest and best use, feasibility and selection of the appropriate management company.

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