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More Hotels, Roads 'Key' to Kaliningrad

By Alec Luhn

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Visitors walking in front of the tents that comprise the only big-venue business exhibition center in the regional capital. **Alec Luhn**

KALININGRAD — Kaliningrad's Baltik-Ekspo is not your standard business exhibition center.

The only major conference center in the capital city of Russia's Baltic Sea exclave, it consists of interconnected white tents in the middle of a muddy patch of grass. Cars are parked around it randomly.

On a Thursday last month, the Kaliningrad region's deputy chairman and de facto tourism director, Sergei Karnaukhov, was lamenting the state of the region's tourism at a news conference in one of those tents. He said over and over: "We need comprehensive infrastructure."

Kaliningrad "has no quality business event venues" and lacks affordable quality hotels, he told The Moscow Times following the conference. He was blunt about the hurdles faced by the region, which draws fewer than 500,000 tourists a year. "We could increase the flow of

tourists to 2 million, but they would come and see what they shouldn't see," he said. "The issue today is not increasing the flow of tourists, but rather creating adequate infrastructure."

International hotel brands, more hotel rooms and more roads are part of the plan for the region's development as a tourist destination. But those components — each of them needed for attracting more tourists and business travelers — are in varying stages. Some hotels have been built, while others are in planning mode and some projects are on hold. But economic incentives particular to the exclave could help the hotel and tourism efforts.

Much has been expected of the hotel sector in Kaliningrad and of the region as a whole. The westernmost piece of Russia, Kaliningrad became a special economic zone in 1996 and will remain so, with an emphasis on recreation and tourism, until 2031. Before the global financial crisis all but froze new construction, a handful of international hotel brands had been planning to construct large hotels in the region.

Many expectations haven't panned out. Hilton's project in the city center — RIA-Novosti reported in 2008 that the project was to include an eight-floor, five-star hotel with a construction price tag of 80 million euros ($113 million) — was never built, and other international hotel projects remain on hold.

Today, however, Russia's economy is improving, foreign investment is increasing, and Kaliningrad is expected to be one of the host cities for Russia's successful bid for the 2018 World Cup. As a result of those trends, some developers and officials said the region is ready to fulfill its potential for growth, especially in the hospitality industry.

Tax breaks related to Kaliningrad's status as a special economic zone, as well as a federally sanctioned gambling zone planned for the region, may also attract hotel-sector investment. Thus far, however, no investors have signed on to build the "Baltic Las Vegas," as some media outlets have dubbed the city's future.

Chicken or Egg?

Hotel rooms in Kaliningrad have been accumulating, increasing from 25,000 in 2009 to 40,000 in 2010, and the figure will reach 50,000 by next year, said Anna Mitrofanova, a tourism expert at Kaliningrad's Immanuel Kant Baltic Federal University.

Small hotels and guesthouses form the backbone of Kaliningrad's hospitality industry and continue to be built. But it will take big projects by international operators to substantially alter the region's hotel market, developers and consultants said.

Currently, the big offerings are few in number. The Radisson Hotel Kaliningrad is the only major international brand hotel in Kaliningrad, and it has 178 rooms and four-star accommodations. There is also the four-star, 119-room Kaiserhof. In the construction phase is a 175-room Ibis-brand hotel, which Turkey's Akfen is building in the city center and which France's Accor Group will manage. Along the Baltic Sea coast, French-Russian developer Mersfor Rus is planning to build Prussian Village, a much-delayed project near the town of Pionersky that will include three-, four- and five-star hotels.

"The hotel business, if correctly realized, has a very high potential here," Karnaukhov said,

noting high occupancy rates at local hotels such as the Kaiserhof.

“Here it’s difficult with four-star hotels, hotels with high quality but not a high price. There isn’t enough of them,” he added.

Some hotel operators and analysts cautioned that Kaliningrad’s current number of visitors couldn’t support expansion of the local hotel market.

“When there’s not more than 200,000 foreign tourists in general [each year], what market can we talk about?” asked Stanislav Ivashkevich, associate director of hospitality development in CB Richard Ellis’ strategic consulting and valuation department.

The region’s infrastructure would need to be developed more before the hotel sector in the city of Kaliningrad can grow, Ivashkevich said. He noted, though, that there is a potential market along the region’s underserved Baltic Sea coast.

The city of Kaliningrad attracts much of the Kaliningrad region’s business tourism, since it’s the business and cultural center of the region. By comparison, the Baltic coast, with its therapeutic mud and mineral water, beaches and the scenic sand dunes of the Curonian Spit, garners a large share of the leisure tourism.

Earlier this year, the Kaliningrad regional government created the Kaliningrad Regional Tourism Agency to promote the industry, and the budget of the region’s tourism target program is expected to increase next year, the agency said. But that budget is small: It will increase from 16 million rubles ($570,000) to just 22.5 million rubles ($800,000) next year, according to the agency.

What’s more, before the region can draw more tourists, it will need to construct the infrastructure to host them, Karnaukhov said.

Government Efforts

To that end, the regional government is building a ring road around the Kaliningrad Peninsula — expected to be completed in 2015 — and is seeking an investor to finish the now-halted reconstruction of Khrabrovo Airport, which serves the city of Kaliningrad and the region itself. It also needs to attract developers that can revamp the hotel sector.

Karnaukhov said the regional government is prepared to lead investors by the hand through the initial phases of a project, including the arrangement of meetings between officials and potential investors. In addition, the Kaliningrad Regional Tourism Agency “is preparing proposals for investors in the hospitality and service industry,” said Yelena Kropinova, the agency’s director.

In 2011, local officials helped speed the construction of the Radisson Hotel Kaliningrad, its Russian developer said.

“They’ve helped us out in coping with Russian bureaucratic procedures, in order to get all the authorizing documents ASAP,” said Alexandra Stryukova, hotel development director for developer Clover Group. “It really accelerated the process, and we started the construction itself even earlier than planned.”

By the Numbers

* 20-25 large and medium commercial real estate projects currently being built in Kaliningrad
* 22.5 million ruble ($800,000) budget planned for the Kaliningrad tourism target program in 2012
* 1 large international brand hotel
Source: MT research

Consultants and officials agreed that the Kaliningrad hospitality industry is ripe for new development, but they didn't agree on where or how.

At a round-table discussion in April, the "City of Kant" Non-Profit Partnership's Board of Real Estate Experts echoed Karnaukhov and Mitrofanova's gripes about the lack of quality in the hospitality industry.

The majority of hotels in Kaliningrad are small and privately owned, meaning that few are built to modern standards, said Yevgeny Girsa, general director of local developer VYaZ-Development. Except for the Radisson, recently built hotels in the region tend to have just 20 rooms to 30 rooms each, he said.

"The large operators that would have given the needed quality — they're not here," Girsa said.

Girsa's fellow board member, Oleg Shaduikis of ING Consulting Group, disagreed, saying that virtually all hotels in Kaliningrad are comparable to those elsewhere in Europe. "They may only have three or four stars, but they're on the European level," Shaduikis said.

The Radisson Hotel Kaliningrad was built last year for 1.3 billion rubles ($46 million) in the city's center. Operated by Belgium-based management company Rezidor Hotel Group, the hotel has experienced a gradual rise in its occupancy rate since its opening in September, said Sean Pitchfork, the hotel's executive assistant manager. Last month, it reached a 28 percent occupancy rate, and the rate will reach 45 percent to 50 percent this summer, he predicted.

The Radisson was the first to have extensive conference facilities, including a large hall that can fit 400 people and seven smaller rooms, Pitchfork said. He estimated that business tourism makes up 80 percent of all tourism to Kaliningrad.

As for overall hotel market prospects, Pitchfork said Kaliningrad doesn't have "the volume of traffic in the business or leisure segment to support more hotels."

Nonetheless, Akfen and Accor have started building the Ibis Kaliningrad in the city center, with the opening planned for 2013. In addition, Hilton is currently "in discussions regarding a site in the town, though nothing has been confirmed at this early stage," a spokesperson said.

On the Waterfront

The most ambitious new project is located along Kaliningrad's coastline, where the market is far from saturated, industry consultants and officials said. Prussian Village and its array of hotels is part of that project, called "Amber Coast" because 90 percent of the world's naturally made amber comes from the Kaliningrad region. Amber Coast is an internationally financed project by Russian developer Mersfor Rus, and it includes Prussian Village, the Amber Coast Marina and Resort and a horse-racing track near the planned gambling zone in Povarovka. The marina and hotel projects are located in and around Pionersky.

The plans for Prussian Village spell out a five-star hotel with 80 rooms, a four-star hotel with 150 rooms and a three-star hotel also with 150 rooms. Prussian Village also will include 12 guesthouses and boutique hotels, each with 24 to 48 rooms, said Mersfor Rus spokeswoman Yulia Orekhova. She said a Luxembourg investment fund will finance the project but declined to give more details.

The marina and yacht aspects of the construction have been delayed. As far back as 2008, Mersfor Rus was working on Amber Coast with French-led developer Amber Land to transform Pionersky's fishing port into a passenger marina with a yacht club and resort. Those plans were put on hold indefinitely because of legal difficulties related to structuring a proposed government-private partnership, Orekhova said.

"The project can't be started until the ownership and investment legal relationships between the developer and the government are formulated," she said.

Elsewhere along the coast, Dutch hotel chain Golden Tulip is reported to be in discussions with local authorities about a four-star, 180-room hotel and spa center in Zelenogradsk. In Pionersky, there will be Bismarck's Cottage, a government residence to be completed this year at a reported cost of 3 billion rubles ($107 million).

Though major foreign projects are cropping up in Kaliningrad, a number of factors could hamper the emergence of a broader trend. Ivashkevich said Kaliningrad won't see significant growth in the hotel sector for at least the next five years. Although the region's tourism is centered on business, as a business center it has little to offer, he said.

Likewise, Kaliningrad isn't much as a tourist destination, Shaduikis said, since there are few well-known attractions or landmarks other than the grave of philosopher Immanuel Kant and the Curonian Spit, a UNESCO World Heritage site. Furthermore, few airlines offer direct flights to the Kaliningrad region, and Russian visas are complicated and expensive for many foreigners.

Although foreign investment in Kaliningrad has been on the rise following the crisis — reaching $100 million in 2009 and $160 million in 2010 — it faces significant administrative and legal barriers, said Oleg Skvortsov, managing director of the Foreign Investors Association in the Kaliningrad Region.

Nonetheless, recent developments give Skvortsov cause for optimism, such as increasing access to once limited and therefore expensive utilities. And where "access to infrastructure appears ... investors appear," he said.

But Skvortsov maintained that, by far, the most positive factor for Kaliningrad's investment prospects is its role in the World Cup in 2018.

"The development of the hotel sector, the service sector, the transport sector ... all will go forward in big steps," he said. "We will build infrastructure."

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