

Spotlight European Serviced Apartment Market

Q1 2014



SUMMARY

■ Some operators are reducing their reliance on long stay corporates by appealing to shorter stay business and leisure guests.

■ Declining reliance on Travel Management Companies (TMCs) has meant brand exposure has become more important.

■ As a result operators are expanding by developing an overtly branded stand alone product.

■ International arrivals to Europe are forecast to improve, as are managed corporate trips, pointing to improving demand.

■ Amsterdam has the most constrained supply of the eight European cities examined, with 0.2 units per 1,000 overseas visitors.

■ Paris and London have 0.3 and 0.6 units respectively, but this still lags supply in major US and Asia Pacific cities.

■ Operators have established new brands in order to maximise their appeal to different guest segments.

■ The expansion of purpose built branded stock across Europe should help legitimise the sector for investors, in turn boosting transaction levels.

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“Europe's gateway cities continue to offer expansion opportunities for operators pursuing branded development”

Tim Stoyale, Savills Hotels
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➔ **Tapping into the shorter stay segment**

■ The evolution of the serviced apartment sector in Europe has seen an increasing number of operators develop expansion strategies focused on key gateway cities.

■ This is largely down to the sector's traditional demand profile, which has seen it largely appeal to corporates on extended stays. As a result, major cities with a sizeable financial & business services sector have offered the greatest opportunities for expansion.

■ However, there is an emerging trend amongst the larger operators to move away from a reliance on long stay corporates and increase their appeal to the shorter stay business and leisure segments.

■ In order to achieve this, operators are primarily expanding their inventory through the development of an overtly branded stand alone product more closely aligned to Aparthotels. This is in contrast to its previous expansion in Europe which was dominated by local operators taking on single units in traditional residential blocks.

■ One of the drivers of this is the falling reliance on Travel Management Companies (TMCs) with corporates increasingly arranging their own travel due to the greater choice and flexibility it provides. Tapping into the leisure segment also provides a valuable operational boost during the typically quieter weekend periods. By developing a branded purpose

built product operators can improve their ability to access this shorter stay demand as it allows operators to provide a uniform offer, boosting guest confidence.

■ Zoning/planning issues have also driven the movement towards purpose built expansion as it provides greater security of operation.

■ For example, in London those residential units (C3 planning consent) being used as serviced apartments cannot be let for periods of less than 90 days unless they are in possession of a daily letting license, which is difficult to secure, or have special consent from the Local Planning Authority. As a result operators, in some cases, face the risk of eviction if they are found to be in breach of these planning regulations.

■ Amsterdam has a similar issue in that stays of less than one week are only permitted in a hotel or bed & breakfast.

■ Yet, the advance into the shorter stay market is not without its difficulties. One of the biggest being booking technology.

■ Hotels have been offering live booking systems for some time, but its use by serviced apartment operators is limited due to a number of factors. The primary one being the balancing act between the longer stay and shorter stay guest. For example, avoiding instances where leisure bookings clash with long stay corporates that have been offered the flexibility of extensions on short notice.

■ Those operators that implement the technologies and strategies that master this balancing act are likely to be most successful at maximising demand from both the corporate long stay and shorter stay segments.

Demand across Europe set to increase....

■ International arrivals for Europe have largely tracked GDP for the region (Graph 1), with arrivals falling 5.2% in 2009 in line with the 4.5% fall in GDP. However, by 2011 arrivals were already back above their previous 2008 peak.

■ Improving economic conditions should see arrival numbers increase by an average of 1.6% per annum over the next four years. The United Nations World Tourism Organisation (UNWTO) forecast that arrivals will hit 608 million by 2018, 47% of global international arrivals.

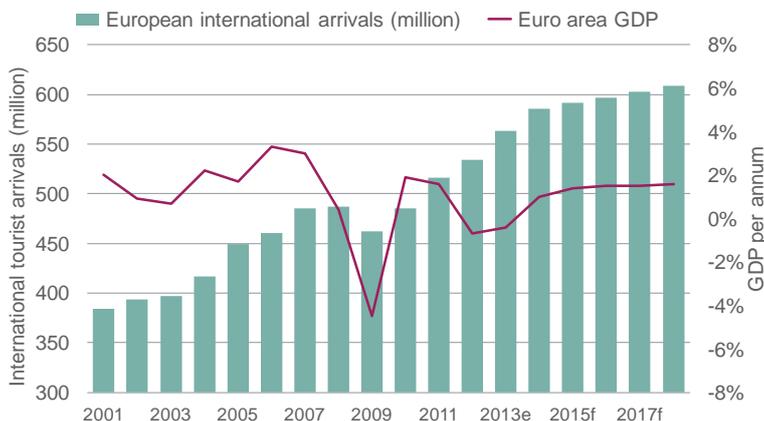
■ Corporate demand is also expected to pick up with The Business Travel Show's Annual Business Buyer survey noting that 49% of respondents expected the number of managed trips to increase in 2014.

■ This future growth in arrivals and managed corporate trips points to improving demand. However, competition, including that from hotels, branding and demand profile will determine how successful operators are at accessing this demand.

...but, what cities to benefit?

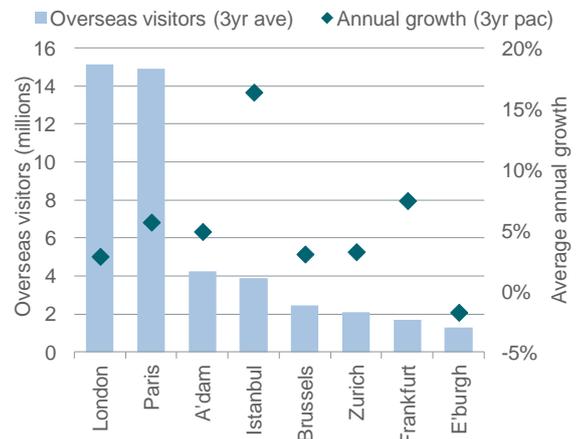
■ Based on a list of gateway cities, derived from operators target markets,

GRAPH 1 **European international arrival forecasts**



Graph source: UNWTO; Focus Economics

GRAPH 2 **Overseas visitors (staying overnight)**



Graph source: National Statistics

we have examined existing supply relative to visitor numbers.

■ While the sector has traditionally appealed to business visitors the aspiration of some operators to access the leisure segment has meant we have examined total international visitor numbers.

■ This analysis does not suggest what markets are over or under supplied, rather it provides an indication of the potential scope for further expansion. The larger the city bubble the greater the potential demand due to the size of its visitor market.

■ Examining visitor profile in terms of length of stay, type of visitor (business vs leisure) and hotel performance would be needed in order to provide a better indication of how the serviced apartment sector could perform in a given city.

■ London and Paris have the largest overnight visitor markets with an average of 15.2 and 14.9 million overseas visitors per annum (3-yr ave) respectively indicating greater levels of potential demand. The remaining cities attract between 1.7 and 4.7 million overnight overseas visitors (Graph 2). In growth terms Istanbul leads with an average increase per annum of 16% over the last three years.

■ When you factor in existing supply Amsterdam would appear to have the most constrained serviced apartment supply with 0.2 units per 1,000 overseas visitors. Paris and London are not far behind with 0.3 and 0.6

units respectively (Graph 3).

■ Brussels and Frankfurt are the better supplied markets both with 1.1 units per 1,000 overseas visitors.

■ Even these apparently better supplied markets, however, lag the supply levels seen in US and Asia Pacific cities where the serviced apartment concept and its brands are more familiar to consumers. For example, supply in New York stands at approximately 5.8 units per 1,000 overseas visitors and 2.9 units in Hong Kong.

Supply relative to hotels remains low

■ While all these cities demonstrate opportunities for expansion some have more 'developed' serviced apartment markets than others based on stock levels relative to that of hotels.

■ Presence of international branded operators is a further indication of how sophisticated a market may be. Although, as seen in the hotel sector 15 years ago, markets will be dominated by unbranded local players. As the sector develops the proportion of branded stand alone operators will increase.

■ Zurich and Brussels lead with serviced apartment units accounting for 17% and 15% of hotel supply. In the case of Zurich supply is almost exclusively all operated by local players. Brussels on the other hand does have some international operators present such as Ascott's Citadines brand and Accor's Adagio.

TABLE 1 **Overview of selected operators**

Operator	Brands	Selected pipeline
Ascott	Citadines Ascott Residence Somerset	Citadines Hamburg 2014 Citadines Frankfurt 2014 Ascott St James London 2015
Accor	Adagio Adagio Access Suite Novotel	Adagio Paris 2014 Adagio Birmingham 2014
Bridgestreet	Exclusive Residences ApartHotels Living Places Studyo	Confidential UK site 2015/16
Frasers	Fraser Suites Fraser Place Fraser Residence Modena Capri	Capri Frankfurt 2014
IHG	Staybridge Suites Candlewood Suites	Staybridge London 2015 Staybridge Manchester (no date)
Staycity	Staycity	Staycity London 2014 Staycity Lyon 2014 Staycity Venice 2014

As a result international branded supply accounts for approximately 50% of current serviced apartment stock.

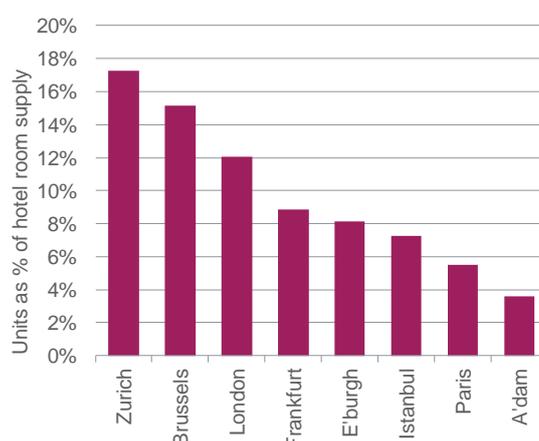
■ London, traditionally the primary target for international operators wanting to expand into the European market, also has a relatively well developed serviced apartment segment. Supply currently accounts for 12% of total hotel rooms and while international branded supply accounts for only 30% of total stock it has the greatest number of international operators present compared to other European cities. These include Ascott, Frasers, Staybridge Suites, Bridgestreet and AKA all operating single or multiple properties. Despite London's relative sophistication, there remains significant scope for further expansion.

GRAPH 3 **City supply relative to potential demand**



Graph source: Savills; National Statistics

GRAPH 4 **Supply relative to hotels**



Graph source: Savills; National Statistics

➔ ■ At the other end of the spectrum Amsterdam serviced apartment units account for only 4% of hotel room supply, the lowest across the eight cities examined. It is also one of the most fragmented markets. Supply is dominated by small local operators with individual residential properties across multiple locations. There are also no major international operators currently in the city, with only a handful of stand alone blocks offering in excess of 20 units.

International operators on the expansion trail

■ The bounce back in international visitors to Europe, combined with changing trends in both the business and leisure traveller segments, means that a number of international operators are looking for expansion opportunities. Table 1 highlights some of these operators and their future pipeline where known.

■ Ascott will open sites in Frankfurt and Hamburg later this year and are also looking for opportunities in Amsterdam.

■ Frasers will open their first European 'Capri by Frasers' branded operation in Frankfurt. This is Frasers latest brand targeting the shorter stay guest and is most closely aligned to an Aparthotel.

■ StayCity is pursuing a 30% growth in inventory planning to expand to 5,000 apartments across Europe by 2019 with new sites expected to open in Venice, Lyon and London this year.

■ The expansion of purpose built stock has also been accompanied by operators developing new brands in order to appeal to different guest segments.

■ The expansion of purpose built branded supply across Europe should help legitimise the sector for investors. Even London, which has one of the more sophisticated markets by European standards, has seen relatively little investment activity with the institutional investors remaining largely absent.

■ Our expectation is that this will change as more 'institutionally friendly' stock operating within the appropriate zoning/planning comes on stream. Increasing consumer awareness around the sector and its brands will also prove beneficial both from an investment and operational perspective. Although when this institutional investment does materialise this is likely to be focused on the major European cities in the UK, Germany and France initially. ■

OUTLOOK

Legitimisation of the sector, via the development of purpose built stock, to pick up pace.

■ Expansion by international operators is expected to pick up pace over the next three years, with the focus primarily on London, Paris, Frankfurt and Amsterdam.

■ Competition and land costs in these gateway cities may lead more operators to test new brands in secondary cities before rolling out to the key target markets.

■ Branded, purpose built development is expected to dominate growth of the sector going forward. This should raise greater awareness amongst consumers, potentially boosting demand from the leisure segment.

■ This movement towards purpose built product will further differentiate the sector from traditional corporate housing.

■ Private equity will be the primary driver of purpose built expansion over the short term, which will help legitimise the sector for institutional investors. When this institutional demand does materialise it is likely to be focused on the major cities in the UK, France and Germany initially.

Please contact us for further information



James Bradley
Hotel Valuations
+44 (0)20 7409 8771
jbradley@savills.com



Tim Stoye
Head of Hotel Valuations
+44 (0)20 7409 8842
tstoye@savills.com



Archie Hunter
Hotel Transactions
+44 (0)20 7409 9913
ahunter@savills.com



Robert Seabrook
Head of Hotel Transactions
+44 (0)20 7409 8106
rseabrook@savills.com



Marie Hickey
Research
+44 (0)20 3320 8288
mlhickey@savills.com



Dennis Leib
Netherlands Investment
+31 20 301 20 48
d.leib@savills.nl



David Poole
France Valuations
+33 (0)1 44 51 73 10
dpoole@savills.fr

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