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Spotlight
European Extended Stay Market

2016

SUMMARY

■ Evolving consumer preferences, primarily amongst millennial business travellers, is set to be a key driver of demand for extended stay product.

■ The acceleration in the rollout of extended stay concepts by a number of global hotel operators reflects a growing awareness of the potential scale of extended stay demand in Europe.

■ Examination of underlying fundamentals related to supply and demand across 35 European cities identified a number of 'opportunity' markets for expansion. The top five cities included Amsterdam, Barcelona, Berlin, Dublin and Stockholm.

■ European transaction volumes were up 32.9% in 2015 on the previous year. With an annual volume of €416.5m, however, it remains a relatively 'niche' sector albeit this reflects lack of built institutional grade stock rather than lack of investor appetite.

■ Some operators are moving into PRS with a 'hybrid' model. This has the potential to drive additional investment into the sector in general and plus improve the yield profile over a traditional PRS operation.

"Prospects for stock expansion and investment in the sector have improved; the scale of potential demand and possibility to tap into the PRS market will open up significant opportunities."

Marie Hickey, Savills Research

Adoption of 'Extended Stay' terminology

The term 'Serviced Apartment' has been the most commonly used term in Europe, reflecting the sector's emergence out of the short-stay residential model. But, what has become apparent is that this is no longer useful as an umbrella term, particularly due to the growth of Aparthotels.

A common feature across the sector is that product is largely aimed at those on longer stays. As a result we have decided to adopt the terminology used in the US of 'extended stay', a useful umbrella term encompassing everything from Aparthotels to Corporate Housing.

Realising the potential

Aparthotels have been the fastest growing segment of the extended stay sector, and for a number of the large global hotel operators this is mirrored across their stable of brands.

The acceleration in the rollout of extended stay concepts by a number of global hotel operators, such as Marriott's Residence Inn and Staybridge Suites by IHG, reflects their drive to develop specific brands and concepts targeted at particular traveller types and/or demographic groups. The growing awareness of the potential scale of extended stay demand, has also been key to the speed at which this product is being rolled out.

The potential scale of 'unmet' demand was highlighted by a consumer survey carried out by Bridgestreet Hospitality (an extended stay operator). Thirty-three per cent of business traveller respondents noted that their typical trip was for more than five nights (Graph 1). Using this as a proxy, this suggests there were potentially 26.8 million international business arrivals to Europe in 2015 whose trips were for more than five nights. This is a sizeable target market for extended stay operators. In London alone there were 6.3m extended stay trips by overseas visitors in 2015 (holiday and business trips).

The ability of Aparthotels to tap into both the corporate and leisure market, including those on shorter stays, is making them increasingly attractive from a revenue management perspective. A mixed guest profile helps operators maximise yields, minimising what would typically have been quieter weekend periods. Couple this with the fact that operating costs for extended stay operations tend to be lower than an equivalent full service hotel, means extended stay assets have the capacity to achieve higher returns.

Consumer trends

Changing attitudes to business travel, particularly amongst millennial travellers, is also aiding expansion.

The emergence of 'bleisure', where business travellers add leisure days to their trips, has gained momentum over recent years, being more prevalent amongst younger travellers. In the same Bridgestreet survey respondents were asked if they were more or less likely to take a 'bleisure' trip than they were five years ago - 60% responded that they would be more likely (Graph 1).

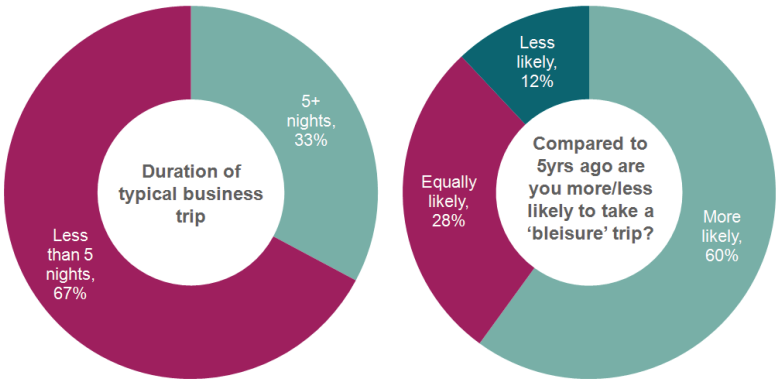
Why is 'bleisure' important to extended stay? Essentially, these trips are longer than the average business or leisure trip suggesting that an extended stay product may have more appeal. Also, of those who said they took bleisure trips, 54% said they brought their family, again a guest segment that may find extended stay more attractive. With millennials forecast to account for 50% of business travellers by 2020, this trend looks set to become more pronounced over the next five years and should prove an important driver of operational demand going forward.

The success of Airbnb has also played an important role in raising awareness of the sector. Originally seen as a major disrupter, Airbnb has actually raised the profile of alternative forms of accommodation, such as extended stay.

While it has been beneficial in one respect it does present competition challenges. According to Airbnb, business travellers now account for 10% of bookings and could rise following their recent tie-ups with three of the world's largest corporate travel bookers. However, while there would appear to be a growing appetite for non-hotel/Airbnb offer amongst corporates, only 18% of corporate travel policies allow employees to expense Airbnb bookings. This suggests that there is a gap between user preferences and what corporate travel policies currently allow. Extended stay has the ability to bridge

GRAPH 1

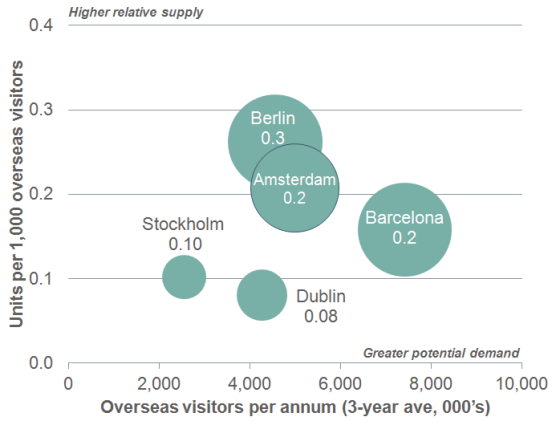
Significant proportion of business travellers on extended stay trips



Graph source: Bridgestreet Bleisure Report 2014

GRAPH 2

Unit supply relative to overseas visitor numbers



Graph source: Savills Research; AMPM; National Statistical Offices

this gap, satisfying user demand and the policy requirements set by corporates.

Identifying opportunity markets

In previous reports we have highlighted the relatively constrained levels of extended stay stock that exists across Europe's key gateway cities, compared to more developed markets in the US and Asia Pacific. Some cities, however, may prove to be more attractive 'opportunity' markets.

In order to identify these 'opportunity' markets we examined the underlying fundamentals related to supply and demand across 35 European cities. This involved examining and benchmarking a number of metrics such as the size of a city's economy, presence of large corporates, size of its overnight visitor market, and existing extended stay and hotel stock. These metrics were then scored and weighted to produce a total score for ranking purposes.

The top five cities identified from the analysis were (in alphabetical order) Amsterdam, Barcelona, Berlin, Dublin and Stockholm. Each market performed well in terms of their underlying operational fundamentals, however, what really placed them at the top of the ranking was their constrained supply levels.

Dublin and Stockholm had the most constrained stock levels relative to their overnight visitor market. Dublin has 0.08 extended stay units per 1,000 overseas visitors, Stockholm 0.10 units (Graph 2).

Dublin has seen a number of large international technology companies establish their European HQ in the city, such as LinkedIn and Facebook. This source of corporate demand, plus the city's expanding leisure appeal which saw international arrivals increase 13.7% in 2015, are all enhancing Dublin's attractiveness from an operator perspective.

Despite not featuring in the top five, London and Paris did place in the top 10. Both cities are relatively better supplied with 0.60 and 1.08 units per 1,000 overseas visitors respectively, but compared to other developed markets in the US and Asia Pacific this still looks limited. For example, New York and Hong Kong have, on average, approximately 5 units per 1,000 international arrivals. While the UK's vote to leave the EU in June is generating some uncertainty from both an operational and investment perspective, it is too early to say what the actual implications will be. We have, however, provided some thoughts on the back page.

Who are the operators?

The European market, on the whole, remains fragmented with supply largely dominated by local operators. Table 1 below provides a snapshot of a selected list of major operators and their brands in Europe.

Similar to hoteliers, extended stay operators are largely pursuing an asset light strategy by expanding via leases and management contracts (MC). There are some exceptions. Singaporean operators, Ascott and Frasers Hospitality, for example, are largely acquiring assets for operation.

While a number of the large US brands do have a presence in Europe it remains comparatively limited. We are, however, starting to see much more active pursuit of opportunities from this group in order to expand their European portfolios. For example, some national and international brands are offering parent guarantees and key money, as well as other structures, to facilitate the development of new stock.

More stock please

The ability of operators, such as Staycity and Adina, to offer leases has supported strong stock delivery. The ability to offer leases, particularly in prime markets/areas where competition from other property uses is significant, can improve the likelihood of an operator securing sites. This in turn helps to deliver more institutional grade product into the market, which has to date been relatively scarce. It is this delivery that will be key to facilitating further investment into the sector.

The historical investment challenge for the sector was a lack of concept and brand awareness. Private and overseas investors became more comfortable with it as an asset class far quicker than institutional investors. However, improving appetite for 'hospitality' assets from the institutions has seen some look more favourably at extended stay, viewing it as a part of the wider hotel market rather than something totally unique.

TABLE 1

Selected European operators

Group - brands	Origin	Active geographies (Europe only)	Operational model	Current stock (Europe only)
Accor - Adagio; Adagio Access	France	Pan European	Leases, MC; Franchise	c.10,000
TFE Hotels - Adina Apartment Hotels	Australia	Pan European	Leases; MC	c.900
Ascott - Citadines; Ascott Residences; Somerset	Singapore	Pan European	Owner operator; Leases	c.4,000
Frasers Hospitality - Fraser Suites; Fraser Place; Fraser Residence; Capri	Singapore	Pan European	Owner operator	c.1,100
Go Native	UK	UK	Leases; MC	c.900
Marriott - Marriott Residence Inn	US	Pan European	MC; Franchise	c.200
SACO - SACO; Locke	UK	UK	Leases; MC	c.800
Staybridge Suites (IHG)	US	UK	MC; Franchise	c.700
Staycity Aparthotels	Ireland	Pan European	Leases; MC	c.1,400

Table source: Savills Research; AMPM; Annual Report

Improving awareness has helped to boost transactional volumes. Activity in Europe in 2015 was up 32.9% on 2014. Recent notable transactions include the purchase of Staycity Heathrow (Hayes) by Schroders UK Real Estate Fund for €41.5m reflecting a 5.5% yield. In Germany, Deka acquired an Adina property in Frankfurt for €39m. However, with volumes of €416.5m across Europe it remains a relatively 'niche' market largely down to the fact that there is relatively little institutional grade stock in existence. As new purpose built stock is delivered, this is set to change.

There are a number of features, unique to extended stay, that may further boost its attractiveness to investors over traditional hotels, in some cases. For some, its yield profile could prove appealing. Prime hotel yields in the strongest UK cities (fixed lease with strong covenant) are in the region of 4.25% to 4.50%. For an equivalent extended stay property the yield could be up to 100 basis points higher.

This 'risk' premium reflects, to some degree, the fact that the sector is relatively immature. However, this relative discount in pricing is proving appealing to some investors in the current market. On a management contract (MC) basis, the lower operating costs and typically higher occupancy for extended stay, means that the returns for investors could be better than a similar hotel offer, further aiding the sector's appeal.

The recent move into the UK private rented sector (PRS) by some operators could be a real catalyst for future investment into the sector. Extended stay operators are well experienced in 'yielding' properties, and therefore may have the ability to improve the yield profile over a traditional PRS scenario (subject to planning). This could be further enhanced where there is flexibility to place some units into the extended stay market where rates are higher. Considering the investor interest in PRS, this embryonic hybrid approach could further aid demand and investment into the extended stay sector.

Focus on UK

Brexit implications

- One month on from the UK's referendum result to leave the EU and it remains unclear on how the result will impact the UK economy, and more specifically the extended stay market.

- Operationally, over the short term, the weakening of the pound post the vote is expected to have a positive impact on international leisure demand. Some operators have already noted an increase in enquires from the US and Asia Pacific. The potential impact on corporate demand is less understood, although we could see some corporate travel bookers become more sensitive to pricing. We will be watching performance data closely over the coming months to see how demand and pricing is affected.

- While there has been an increase in development, it remains highly constrained, suggesting new supply should be relatively easily absorbed. As this new supply is largely aparthotels, this should help insulate the sector from any potential softening in corporate demand as it has the flexibility to tap into the leisure segment.

- From an investment perspective, UK assets have become cheaper due to the weaker pound improving the attractiveness of UK real estate, and extended stay assets, to overseas investors.

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