Commercial Research – 2022

SPOTLIGHT
*Savills Research*

# European Serviced Apartment Market

savills


- Faster operational recovery
- New brands and growth markets
- Investment overview

# Is operational recovery outpacing that for hotels?

## In our last report we noted that serviced apartments were better placed to weather the fall out from the pandemic, nearly two years on we explore whether this relative resilience materialised.

One thing is clear, every part of the hospitality sector felt the pain of the pandemic as the demand tap was effectively turned off. For serviced apartments, however, the depth of that pain was perhaps less marked with the recovery looking to be outpacing that for hotels.

Using the UK as a benchmark, as of December 2021 London serviced apartment RevPAR (revenue per available room) was 17.9% below that seen the same month in 2019, for London hotels the differential is almost 23 percentage points greater at -40.5%. During the depths of the pandemic, the level of RevPAR decline was also less pronounced. The greatest differential to equivalent pre-covid levels is -81.5% whereas for hotels it was -92.1%. In addition, the sector did not see the same level of RevPAR declines when the UK entered its third lockdown at the start of 2021.

Strong domestic demand has meant the regional UK market has fared better than London, for both serviced apartments and hotels. But, again it is serviced apartments that lead hotels with RevPAR as of December 2021 only 2.7% below 2019 levels with hotels 4.9% below. We are aware of the VAT rate variance between the two periods, although in many cases these VAT savings haven't been passed onto the guest.

**So, why have serviced apartments fared better?**

Well it has a lot to do with the longer staying guests typically found in the sector and the more flexible environment when it comes to the need to social distance. When European markets initially locked down a notable share of guests remained, supported in part by the fact that the environment better facilitated home working. Post lockdowns, the business and leisure demand that did return tended to view serviced apartments more favourably due to better social distancing potential, boosting operational recovery.

**Labour availability issues presenting less of a challenge**

As hospitality demand started to return, particularly during the summer months, labour availability issues across all hospitality segments became particularly acute across Europe.

While this is not a new issue and existed pre-covid and even pre-Brexit in the case of the UK, it was exacerbated by the pandemic as international hospitality workers returned to home countries and/or decided to leave the industry all together. These availability issues are presenting some major operational challenges. For example, in the Savills 2021 operator survey carried out in September, 47% of hotel respondents said the issue was so severe they were having to reduce service levels/ close parts of their hotels to cope. In contrast, only 17% of serviced apartment operators were citing the issue as severe. Rather, the largest proportion of serviced apartment respondents (30%) cited labour shortages as a slight concern reflecting the limited service nature of the sector. This had an implication on perceived wage costs with hotel operators citing a 13% increase in average wages on 2019 levels, ahead of the 10% noted by serviced apartment operators.

The sector's relative insulation to labour issues and rising wage costs has an important read through to profitability, particularly as the labour availability challenges will remain for the foreseeable future. In the wake of the pandemic, the relatively better margins found in the sector is likely to prove a greater draw to investors as income security has moved further up the agenda.

**Operational performance** Serviced Apartment RevPAR has been more resilient than hotels during the pandemic


**Source** Savills Research; ASAP; STR

In December 2021, London serviced apartment RevPAR was 17.9% below equivalent 2019 levels, compared to -40.5% for London hotels

10%

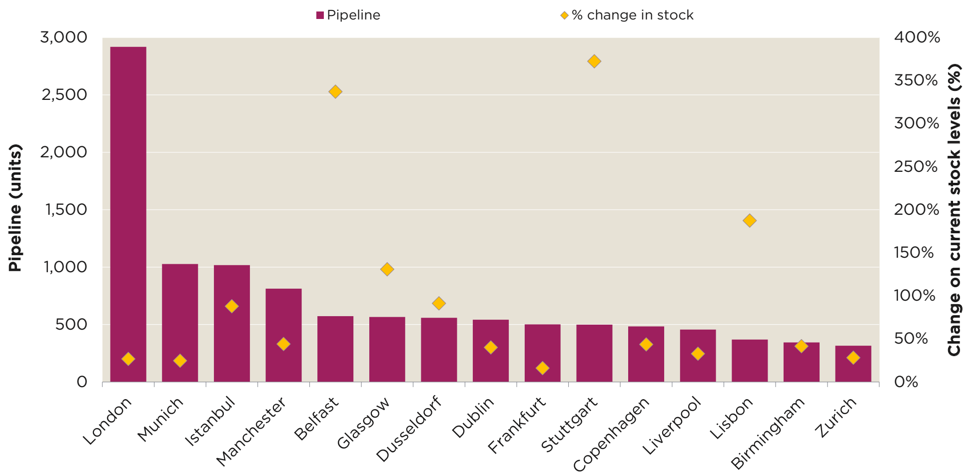
Serviced apartment operators stated that average wage costs increased 10% between 2019 and September 2021

17%

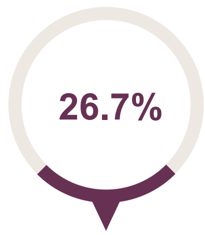
Staff availability issues resulted in 17% of serviced apartment operators reducing service levels to cope, compared to 47% for hotel operators

> European serviced apartment stock expansion is set to accelerate, with supply forecast to expand by 21.2% over the next three years.

**Top 15 European expansion cities** future development pipeline is concentrated across emerging destination and regional cities




**Source** Savills Research; Costar (note: excludes Russia)




London has almost 3,000 units in the committed pipeline, reflecting a 26.7% expansion on current supply

# Stock expansion to accelerate

## London continues to dominate, but it will be emerging destinations and key regional cites in Europe that will lead stock expansion

Supply across Europe expanded by almost 12,000 units since January 2020, a growth of 14.8%. The UK and German markets lead this growth in unit terms, but in percentage terms it was Ireland and Austria that led with 103% and 100% growth respectively.

Based on what is under construction and with final planning, stock expansion is set to accelerate with supply forecast to expand by 21.2% over the next three years, albeit some of this acceleration is down to development projects being delayed due to the pandemic. London continues to be the biggest growth market with just under 3,000 units in the committed pipeline, reflecting a 26.7% expansion on current stock levels. Beyond London and Munich, the latter of which is already a major market in supply terms, it is key regional and emerging destination cities in Europe that are leading future expansion rather than the traditional gateway destination cities. For example, Istanbul and Manchester rank third and fourth based on unit pipeline count, with Stuttgart and Belfast leading in growth terms with 372% and 337% respectively (albeit reflecting growth off a low base). This shift reflects a combination of rising developer and investor awareness of the sector and its operators, alongside operator appetite to expand into new, relatively under served markets. These markets also tend to present a greater degree of opportunities as do submarkets within well established cities. For example in the case of London and Munich, the development pipeline is concentrated beyond the core central areas of the city typically associated with hospitality accommodation.

Staycity, Edyn and Accor are the largest groups in supply terms in Europe, helped in part by significant stock expansion over the last three years. They will also continue to be key players in future growth. For example, based on committed pipeline, these three groups account for 22.9% of the total pipeline, representing an average growth in stock of 45.1% over the next three years. For Edyn and Staycity this expansion will be driven by their core brands (Locke and Staycity) for Accor its their budget offering, Adagio Access, that dominates future pipeline.

While we do not expect to see a major shift in the parties driving expansion in Europe, we are starting to see some new entrants accelerate expansion plans. US brand Hyatt House, part of the Hyatt group, added two new sites in 2020 (Paris and Frankfurt) to their first European outpost that opened in 2018, with a London property slated to open in 2022. With Hyatt House being a strategic priority as part of the group's European expansion aspirations, we expect to see further openings.

New, private equity interest in the sector is also helping a number of brands and operators grow their international footprint. APG and Aware Super backed CityID acquired their first international site in London in 2021. Similarly, Fortress Investment Group acquired a majority stake in operator PREM Group in 2021 that will facilitate European expansion, with a particular focus on the Premier Suites segment of the business. Likewise, tech centred, Finnish based Bob W secured additional funding in 2021 which enabled the brand to expand into the UK and Spain.

We expect to see more private equity vehicles enter the market, backing new and existing operators in order to help establish and drive brand expansion. It will be these sector specific brands rather than big hotel group serviced apartment sub brands that will drive European expansion. With 60% of current European stock unbranded, there is still significant opportunity for brand expansion.

The three largest branded groups in Europe account for 22.9% of the committed pipeline

# Trends to watch in 2022 and beyond

In this section, we run through the key demand and operational trends that will shape the sector in 2022 and beyond.

**Greater sector and brand awareness**
Serviced apartments have historically relied on corporate demand and for many operators it remains a key guest segment. Pre-pandemic, corporate accounted for approximately 70% of demand based on the Savills/ Association of Serviced Apartment Operators (ASAP) operator survey. As a result, with a sector apparently so reliant on business travellers, will structural shifts accelerated by the pandemic, such as the greater use of video conferencing, pose a risk to demand and ultimately performance?

Fundamentally, we do not see this as a risk. For example, in many city markets, business traveller numbers never recovered to pre-GFC levels, yet operational performance since the GFC has tended to out perform hotels.

Part of this out-performance is down to longer average stays meaning higher average occupancy rates than hotels. However, it also reflects greater consumer awareness and in turn expanding market share both in the corporate and leisure market. With the pandemic accentuating the benefits of the serviced apartment product, particularly in terms of social distancing requirements, we expect its share of total corporate demand will expand further, offsetting a slower recovery in the wider corporate travel market with new leisure demand providing an additional boost.

**Evolving consumer trends supporting future demand**
Changing traveller preferences post Covid may also provide an additional boon for the sector. The World Travel & Tourism Council (WTTC) in their November 2021 consumer trends report highlighted a potential trend towards longer trips with 52% of global travellers surveyed indicating a preference for longer stays. These longer staying travellers are likely to view serviced apartments more favourably than traditional hotels. The expectation is that this trend towards longer trips will continue post covid, supported by an appetite to combine work and leisure trips, helped in part by the expansion in agile working practices. There is also an environmental angle to longer, fewer trips, as it heps reduce personal carbon footprints in relation to air travel.

**ESG considerations moving up the agenda**
It is very difficult to ascertain the exact impact ESG, particularly the environmental element, will have on guest preferences and in turn overall travel demand. Where we are starting to see it play a role is in corporate RFP requirements. Anecdotally corporates are highlighting that sustainability is now a key issue, amongst others, in their decision process around accommodation selection.

This is reflected in responses to our latest operator survey with the Association of Serviced Apartment Operators (ASAP). When asked how important the ESG credentials of their business was in driving demand 42% of operators said it was very important, with a further 38% stating it was somewhat important. This will no doubt shape estate strategies with 63% of operators surveyed stating that building energy efficiency will be very to extremely important when securing and developing new stock in the future. Some operators are already executing on these aspirations. room2, for example, opened the world's first fully net zero ho(me)tel in London at the end of 2021.

The rising importance of ESG could also see operators refine their offer in terms of reducing kitchen amenities in relation to white goods. This can help to reduce the carbon footprint of the building but can also help to reduce fit out costs and unit sizes, ultimately maximising the building envelope.

**Blurring with Build to Rent (BTR) to intensify**
We have highlighted the cross over between serviced apartments, BTR and co-living before however, there is now a greater focus on cost and inventory management. Something that serviced apartment operators have significant experience in. With investor appetite for BTR to continue, we expect to see more serviced apartment operators move into BTR/ co-living management and or incorporate these elements into their offer. For example, Ascott's co-living brand Lyf secured its first European site in Paris through a joint-venture with the Qatar Investment Authority in 2021, with completion set for 2024.

## Will Dublin be able to absorb the new stock projected to come on stream?

Serviced apartments are nothing new in Dublin. Home grown brand Staycity, now one of the biggest operators in Europe, started out in the city in 2004. Since then, the market has grown substantially, with multiple brands expanding their presence across the city. For example, Edyn's Locke opened two sites, with 401 units, in the city within the last 12 months.

Nonetheless serviced apartments only currently represent 5.3% of Dublin's total hotel stock, which appears relatively under supplied compared against the 8.1% and 9.5% share seen in London and Manchester respectively.

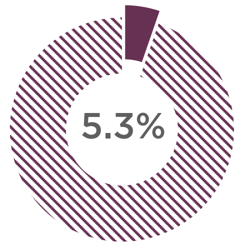
Looking ahead, supply is forecast to increase by over 40% based on what is under construction and in final planning, the majority of which will be delivered in 2022 such as the 340 unit Staycity scheme on Little Mary Street.

The question is then whether the city can absorb this level of stock expansion.

There may be some short lived challenges at a city level considering that most of the pipeline will be delivered this year when demand, particularly from international travellers, will still be significantly below pre-covid levels. However, with corporates such as TikTok, 2K Games and JustEat looking to establish new headquarters in the city alongside existing occupiers such as Facebook, corporate demand for longer-stay accommodation is likely to be quite buoyant. This is likely to be exacerbated by the very tight housing market in the city.

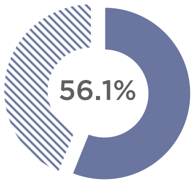
While the level of growth is considerable, the drivers of demand suggest that it should not have a negative impact on operational performance over the medium to long term.

**Serviced apartment share of total Dublin hotel stock (February 2022)**




**Serviced apartment share of total Dublin committed hotel pipeline (2022-2025)**


**Source** Savills Research; AMPM




Since 2018, institutional buyers have accounted for a 56.1% share of European serviced apartment transaction volumes, exceeding the 50.9% share across the wider hotel market over the same period.

# Serviced apartment investment

## Investor appetite continues to accelerate, although a lack of available stock continues to limit transaction activity.

Transaction volumes in the European serviced apartment market reached €496.6 million in 2021. The UK remained the biggest market, accountable for a 47.0% share of volumes, in line with the five year average of 46.6%.

While total volumes were down 42.9% on the previous year, this was off a particularly strong 2020 where volumes increased 8.4% on 2019. Benchmarked to 2019 pre-pandemic levels, 2021 activity was down 38.1%, however this was in line with the wider hotel market where volumes were down 36.5%. While the weaker transactional activity on a year-on-year basis can be partly linked to some trepidation around the wider hospitality market due to the pandemic, it has been stock availability that has been the biggest challenge to activity.

**Institutional appetite accelerates**

The leaner cost structure of serviced apartments coupled with the relative operational resilience during the pandemic has emphasised the sector's less volatile cashflow, relative to the wider hotel space. This has generated heightened interest and confidence amongst investors. PwC and ULI's latest emerging trends survey reinforces this point. When asked about investment prospects in 2022 by sector, respondents ranked serviced apartments six positions higher than hotels (ranking 16th out of the 27 sectors covered).

An increase in leased investment opportunities across the sector is helping to support demand and activity by institutional buyers. Since 2018, institutional buyers (including cross-border acquisitions) have accounted for a 56.1% share of European serviced apartment transactions, exceeding the 50.9% share recorded for hotels. This is a sizeable increase on historical share. For example between 2013 and 2017, institutional capital accounted for 39.1% of volumes. Within this leased space, we have seen a shift towards a more equitable relationship between landlord and tenant, particularly in the wake of the pandemic, alongside the setting of more affordable rents.

In terms of key institutional deals in 2021, abrdn acquired room2 Southampton in February for £10 million in a sale-and-leaseback deal, with the operator signing a 30-year index-linked lease. Similarly, German buyer, Union Investment, completed on the new Wilde by Staycity Aldgate site for £51 million, also with a 30-year lease in place. In Spain, All Iron RE completed the acquisition of a 20-unit tourist apartment building in central Malaga in August 2021, totalling €7 million.

**Yield gap narrows between serviced apartments and hotels**

In previous years, we have noted a c.50 basis point gap between yields on leased hotels and serviced apartments in Europe. This yield differential has since narrowed with indicative yields largely on a par, in line with growing investor demand for serviced apartment product. For example, the aforementioned room2 Southampton deal reflected a yield of 4.98%, largely in line with the sub-5% yields regularly achieved across traditional leased hotel assets in the UK.

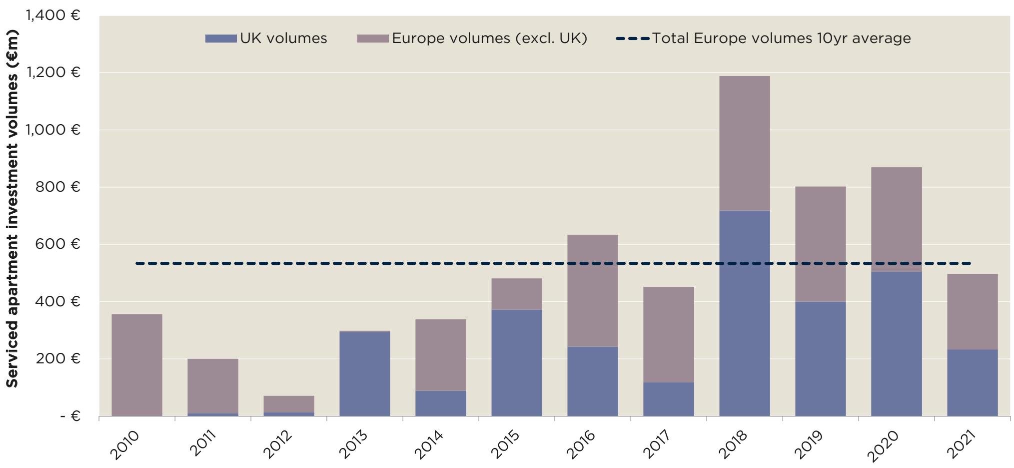
**Platform acquisition will continue to provide the greatest and quickest exposure to the sector**

Future stock expansion will provide more opportunities in regards to specific asset acquisitions, with forward funding deals likely to lead over the short term. However, for those investors seeking more meaningful exposure to the sector, direct investment into new and existing operators and/or platform acquisition is likely to prove equally attractive. As was the case with the stake acquired by APG and Aware Super in operator CityID in 2020, likewise with the Brookfield acquisition of Saco (now Edyn) back in 2018, and we expect to see more of this going forward.

2021 European serviced apartment investment volumes reached €496.6m, down -6.9% compared to the ten-year average

The UK remains the most dominant serviced apartment investment market in Europe, accounting for a 47% share of volumes in 2021

### European serviced apartment transaction volumes




**Source** Savills Research; RCA

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