Commercial Research – 2020

SPOTLIGHT
Savills Research

European Serviced Apartment Market

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- Weathering the storm
- Development opportunities
- Robust investor interest

Are serviced apartments better positioned to weather the storm?

While the Covid crisis has adversely impacted the wider hotel industry, serviced apartments have displayed a relative degree of resilience.

In the face of Covid-19 the hospitality market across the majority of Europe remained effectively closed throughout the duration of lockdown. As economies are emerging from their respective lockdowns, serviced apartments, hotels and hostels have begun re-opening, albeit in many cases this will be in a more phased manner compared to other parts of the market. In addition, travel restrictions and social distancing requirements will mean that operational recovery to pre-Covid levels across Europe may not materialise until at least 2022.

Serviced apartments have not been immune to the unprecedented impact on demand reporting very similar declines in RevPAR to the wider hotel market. However, there are some indications that the sector has been weathering the storm marginally better.

Daily data from STR suggests that UK serviced apartment occupancy, running over April and into early May, was trading marginally above that for hotels at approximately 25%, albeit we are aware of some operators trading above these levels. In addition it has been reported that proportionally fewer serviced apartment properties have had to close compared to hotels. The reason for this marginal outperformance can be attributed to its guest profile and the typical configuration of properties.

While serviced apartments have, on the whole, been successful at capturing a greater degree of short term leisure demand over recent years, its core guest segment continues to be corporates on longer length stays. It has been these longer length guests that provides the sector with higher average occupancy levels, something that has been witnessed on the entry to and during lockdown. For example, London serviced apartment occupancy stood at 61.8% for Q1 2020, down 21.5% on the same period in 2019 as Covid-19 started to take hold in March. Hotels reported a larger decline of 23.0% over the same period with average occupancy at 59.4%.

The fact that serviced apartments can also ensure greater social distancing, helped largely by its self catering facilities, reduced social spaces as well as minimal contact with staff, has also meant that more properties have been able to remain open for their longer staying guests during lockdown.

Additionally, the typically lower operating costs, coupled with longer average length of stay, continues to support profitability of serviced apartments during this period compared to full-service hotels.

The relative outperformance of serviced apartments over hotels during the Covid crisis may be marginal, but it does reflect a trend seen over the longer term highlighting the counter-cyclical features of the sector during downturns.

In the case of London, where there is greater operational performance transparency, serviced apartment RevPAR (revenue per available room) has grown by an average of 3.9% per annum between 2014 and the end of 2019. Over the last three years the uplift has averaged 5.2% per annum. London hotel RevPAR growth has lagged this with an average annual growth of 2.0% over the last five years, with a three year average of 3.3%.

Anecdotally, this outperformance has also been seen during previous recessions. In the aftermath of the Global Financial Crisis (GFC), corporates' use of contract staff, alongside cost sensitivities, meant London serviced apartments experienced a pronounced uptick in operational performance as corporates saw them as a more cost effective alternative to hotels. This is a trend that we could see mimicked across Europe during the recession caused by Covid.

Potential to lead the recovery

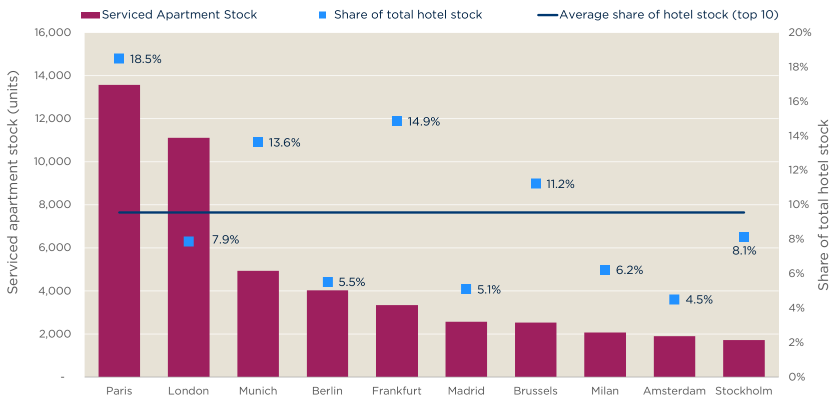
Covid-19 has generated a number of uncertainties. Yet, we can be confident that demand and operational performance will improve. Current expectations are that the recovery will start to materialise next year with STR forecasting a 41%

61.8%
Average serviced apartment occupancy levels in London in Q1 2020, above the 59.4% average for hotels.

5.2%
Average annual RevPAR growth rate for London serviced apartments between 2016-2019.

9.6%
Average share of hotel stock accounted for by serviced apartments across the top 10 European markets.

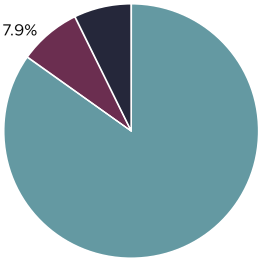
Graph 1: Serviced apartment stock by city (top 10 European gateway cities)



Source Savills Research; STR

"Serviced apartments have not been immune to the Covid crisis but have shown a degree of relative outperformance. As seen historically, this could become more pronounced once recovery starts to emerge."

Graph 2: Available bednights by accommodation type (top 10 European gateway cities)



Source Savills Research; Inside Airbnb; local statistical office (based on top 10 cities for serviced apartment stock)

uptick in RevPAR across Europe in 2021. We examine the initial drivers of this recovery across the wider hospitality market, and potential geographical variations, in more detail in the recovery outlook section.

When it comes to serviced apartments, as seen previously, its recovery could lead that seen in the wider hotel market. This will be largely driven by those features that saw the sector outperform going into the Covid downturn; that is its appeal to those on longer length trips and the greater ability for guests to self isolate, irrespective of length of stay.

The enhanced appeal of serviced apartments over the short term could also have positive read through for medium to longer term performance. The sector, pre-Covid, was already benefitting from enhanced leisure demand on the back of the rising appeal of Airbnb. Post-Covid, greater cleanliness concerns from guests alongside social distancing preferences, and the fact that many Airbnb hosts have removed properties from the listing site, could see the sector capture a greater share of this leisure demand going forward.

In addition, with some development projects postponed and/or shelved in response to the Covid crisis, could prove beneficial to future operational performance as demand returns.

Is there still scope for further expansion?

The current uncertainty has tempered development appetite over the short term and it is likely a number of development projects have been put on hold as a result. However, we have seen continued investor appetite for longer term development projects pointing to continued confidence in the longer term fundamentals of the hospitality sector.

In the case of serviced apartments this longer term confidence continues to be justified. Apart from the demand drivers pre and, potentially, post-Covid, the sector remains relatively under-represented.

Serviced apartments accounted for an estimated 7.9% of bednights across Europe's top 10 gateway cities pre-Covid. This is significantly below the 84.9% allocated to hotels and only marginally ahead of that for Airbnb (see Graph 2).

On a city basis, some markets have a higher representation of serviced apartments relative to hotels. For example, serviced apartment stock in Paris, Munich and Frankfurt represented over 13.0% of hotel supply. In contrast Amsterdam and Madrid have relatively constrained stock levels (see Graph 1).

While a relatively constrained supply benchmarked to hotels does provide some indication of future growth potential, it does not tell the whole picture. Pre-Covid we examined the supply/demand balance across Europe's key gateway cities taking into account bednights available and spent in each city across all commercial hospitality accommodation (hotels and serviced apartments). What this analysis highlighted is that even for those markets well represented for serviced apartments, such as Paris and London, there was still an imbalance suggesting room for further stock growth. Once demand fully recovers, we believe this will continue to be the case.

Investor interest levels remain robust, despite Covid downturn

The relatively small representation of serviced apartment stock in some markets does pose as a barrier to entry for many investors. However, the ongoing expansion of the sector, with a number of major operators continuing to look for development opportunities across key European markets, will support a rise in acquisition opportunities over the longer-term.

In 2019, total serviced apartment investment volumes across Europe reached €551.2m, exceeding the five year average by 16.6%, despite a year-on-year reduction off the back of the peak volumes recorded in 2018 of €903.3m (albeit largely owing to the SACO portfolio transaction).

Year-to-date 2020 investment volumes have waned in light of investor hesitancy caused by Covid-19, and in line with the trend seen across the wider European real estate market. Nonetheless, interest levels for serviced apartment and aparthotel investments remain robust with a number of deals across Europe under offer and looking likely to complete in the second half of 2020. The relative resilience and forecast recovery for serviced apartments in comparison to hotels will likely shine a light on the sector while supporting further interest from investors new to the market.

While we can expect to see marginal short-term yield softening across non-core markets as a direct response to Covid-related pressures, the longer term fundamentals favouring the serviced apartment sector will support pricing over the medium to longer term. What's more, serviced apartment yields across Europe remain relatively attractive, with an average yield spread of approximately 50bps compared to hotels. This is particularly favourable considering other markets such as Asia and Australia tend to see tighter serviced apartment yields in comparison to transient hotels.

€551m

European serviced apartment investment volumes in 2019, exceeding the five year average by 16.6%.

The recovery outlook

European markets with a higher proportion of domestic demand are likely to be better placed to experience a shorter-term recovery to occupancy.

Domestic demand expected to return first

Forecasting has never been an exact science, but the unprecedented nature of the current Covid crisis has made this all the more difficult. Our house view is that overall demand across serviced apartments and the wider hotel market will recover post-Covid as a result of a restored growth in tourism, and corporate travel resuming. It could be the case that the economic implications of Covid could temper demand over the short to medium term but previous shocks rarely result in a fundamental shift in consumer behaviour. However, given the unprecedented nature of the Covid pandemic, there are some smaller parts of the market which may need to adapt during the recovery period in order to recapture their market share, such as hostels and markets reliant on MICE-travel (meetings, incentives, conferences and exhibitions). Current forecasts from STR suggest that European RevPAR across the wider hospitality market will decline 37% this year with a 41% bounce in 2021, with RevPAR rates returning to pre-Covid (2019) levels in 2022. However, this current outlook will be determined by the easing of travel restrictions and any subsequent lockdowns.

Looking to the green shoots of recovery that is emerging in China suggests the initial drivers of the recovery in Europe is likely to be domestic leisure and corporate demand. As seen in China, this will largely benefit markets in leisure destinations outside urban areas and those in close proximity to business districts. As a result it is economy and mid-tier hotels, plus serviced apartments, that could report stronger improvements in occupancy over the short term.

In terms of the geography of this initial recovery, we expect an early improvement in corporate demand is likely to be concentrated on stronger northern European economies, and their key cities, which are expected to recover faster from the economic fall-out from Covid. In contrast, the improvement in domestic leisure demand is likely to have limited read through for demand in Europe's key destination cities as continued social distancing measures may mean that many of the features that make city destinations popular for leisure visitors, such as restaurants, nightlife, cultural and leisure activities are likely to be reduced and/or closed. Again, it could be northern European cities in Germany, Netherlands and Denmark, that may be better placed to capture improving domestic leisure demand as they have been less exposed to Covid-19. This is further supported by the fact that domestic visitors in a number of German cities and Copenhagen have historically accounted for close to 60% of overnight demand on average.

While an early recovery in domestic leisure and corporate demand will be welcomed over the short term as hospitality markets re-open over the next six months, it will only be with a return in international visitor demand that operational performance across Europe's key destination cities can return to pre-Covid levels. Based on current projections from Tourism Economics and STR, this may not start to materialise until 2021.

2020
Forecast RevPAR decline in the European accommodation sector.

2021
Forecast growth in RevPAR in the European accommodation sector.

Source STR

> “Overall demand across serviced apartments and the wider hotel market will recover post-Covid as a result of a restored growth in tourism, and corporate travel resuming.”

Savills Commercial Research
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