

Spotlight European Extended Stay Market

2018



SUMMARY

■ Stock expansion across Europe is forecast to accelerate with the largest operators set to increase their supply by 39.4% by end of 2022; equating to over 13,000 units.

■ Key strategic city markets remain attractive but we are starting to see expansion into emerging growth cities in central and eastern Europe.

■ Extended stay has moved away from being solely reliant on corporate demand, supported in part by the Airbnb effect and emergence of lifestyle focused concepts.

■ In the report we identify a number of future opportunity markets for operators and investors, supported by growing tourist arrivals and a positive economic growth outlook.

■ New development should help boost transactional activity, which has been largely hampered by lack of purpose built stock historically. However, corporate acquisitions may prove the best route of exposure for investors over the short term.

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“Larger operators have gained significant ground in developing pan-european portfolios, yet the market remains disparate meaning that there is everything still to play for.” Marie Hickey, Savills Research
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➔ A refocus on key strategic and emerging markets

The larger European operators (those with a portfolio of 1,000 units) have reported significant growth in unit numbers with average annual growth of 6.1% per annum since 2015. Much of this expansion has been focused on key destination cities in Western Europe, primarily within the UK, France and Germany (see Map 1).

This expansion is due to escalate with stock levels of the largest operators set to increase 39.4% before 2022 year-end, equating to over 13,000 units. Accor, Staycity and SACO are the key drivers of this accounting for 60% of the pipeline, with much of this growth being driven by their new lifestyle focused brands.

UK markets continue to prove attractive with it accounting for a third of the European pipeline, with the focus on the more strategic cities of London, Manchester and Edinburgh. Confidence in London shows no signs of abating irrespective of Brexit, with it dominating the city rankings in terms of pipeline.

In the case of key markets in France and Germany, where competition with hotels and other uses such as offices has intensified, operators are having to offer higher rents in order to secure new opportunities, generating some headwinds to expansion.

Dublin, identified in previous reports as a potential opportunity market, has been receiving significant interest in response to its comparatively low stock levels and rapidly growing overseas visitor numbers. A total of 1,484 units are expected to be delivered by 2022 across 8 projects, including multiple developments from both Staycity and SACO's Locke brand.

Beyond the strategic markets of Western Europe a number of well-established operators have developments secured within emerging markets across central and eastern Europe. Both Warsaw and Vienna, for example, feature in the top 15 ranking for pipeline units in Europe - significantly increasing current supply in each city.

This growth is also being mirrored by smaller emerging operators across Europe with their focus largely on their local domestic markets, although this may evolve into new markets as they expand.

Operators remain bullish

The acceleration in development across Europe is mirrored in the latest ASAP/Savills operator sentiment survey. The net balance of operators stating that they are accelerating expansion vs those scaling back stood at 26.4% in the last survey (anything above zero is positive).

Significant expansion does have the potential to create headwinds in terms of absorption in some markets. Nonetheless, the sentiment survey suggests overall optimism amongst operators will remain positive going into 2019, with a net balance of 13.5%, albeit this has softened slightly compared to the same period in 2017, partly owed to the uncertainties surrounding Brexit.

Looking beyond Brexit

Brexit has generated UK specific economic and corporate uncertainty, and for a sector historically reliant on corporate demand, the question is whether it can weather the storm?

The initial concern was that corporates, particularly financial services, would shift HQ's from the UK to within the European Union. A negative for UK operators, a potential positive for the new host cities in terms of corporate demand. Yet, the real Brexit issue for corporate demand across the region is the potential drag on corporate travel budgets due reduced economic growth across Europe in response to Brexit. For the UK in particular, staff availability post leaving the EU would place further pressure on margins - an issue facing the wider UK hospitality sector.

However, what has become apparent is that the sector's previous reliance on corporate demand has waned. In fact the EU referendum has actually

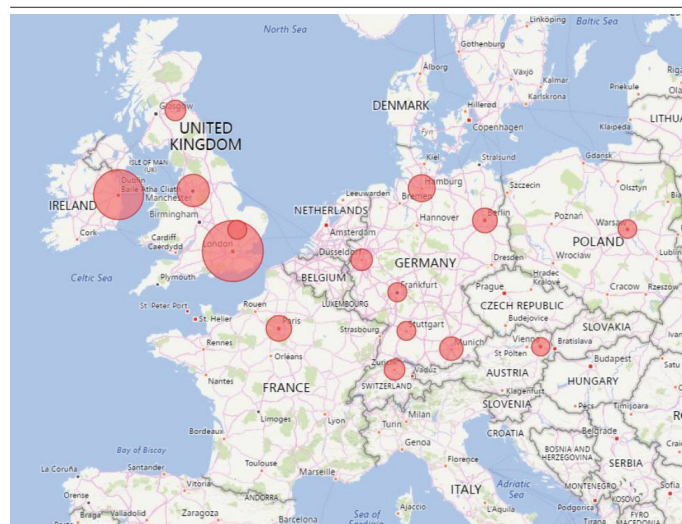
MAP 1

European operator expansion and pipeline to 2022 (operators with 1,000+ units)

Expansion cities (new stock 2014-18)



Pipeline cities (new stock 2018-22)



Source: Savills Research

highlighted the success of the sector to tap into leisure demand, supported in part by the Airbnb effect and emergence of lifestyle focused brands (see opposite). For example, the UK reported 2017 RevPAR growth of 5.7% year-on-year, driven by very strong leisure demand in London and Edinburgh that attracted significant numbers of overseas tourists, boosted further by the weaker Pound.

Future growth markets

The ability to tap into both the corporate and leisure sectors opens up a wider list of opportunity markets, although the focus should remain on destination cities - those that attract international tourists.

Examining tourism growth across European cities, and local fundamentals, highlights a number of potential target markets. This is an approach we have been utilising for a number of years and one that identified Dublin as a target city in 2016.

The below graph identifies the top 20 future growth markets based on a weighted ranking using overseas visitor arrival numbers, visitor growth and GDP growth forecasts.

Within this top 20 there is a 'high growth cluster' including Oslo, Stockholm, Madrid, Edinburgh and Dublin. These markets represent high tourist arrival growth alongside strong GDP outlook - offering operators an



13,000
Extended Stay units to be added in Europe by 2022



8x
Growth in Extended Stay units in Dublin by 2022



18.5%
Average annual growth rate of tourist arrivals in Porto



c.€260 million
European Extended Stay investment volumes in 2017

Emerging Brands

Investing in future-oriented concepts.

While the hotel sector has experienced transformative trends from design-led luxury boutique hotels, a re-vamping of its budget offering and most recently 'lean luxury' midscale concepts, the extended stay segment in general has been less affected by innovation and design over the past decades. This, however, is now changing.

SACO, Staycity and BridgeStreet have all introduced new brands/concepts that are more lifestyle orientated - Locke, Wilde and Mode respectively. Much of the European expansion by these larger operators is being driven by these new concepts, albeit their initial focus has been on familiar markets in the UK and Europe.

Simultaneously, major global hotel chains have been slow to embrace the potential the European extended stay market has to offer, leaving space for innovative new concepts to expand and fill the gap to capture this growing demand segment.

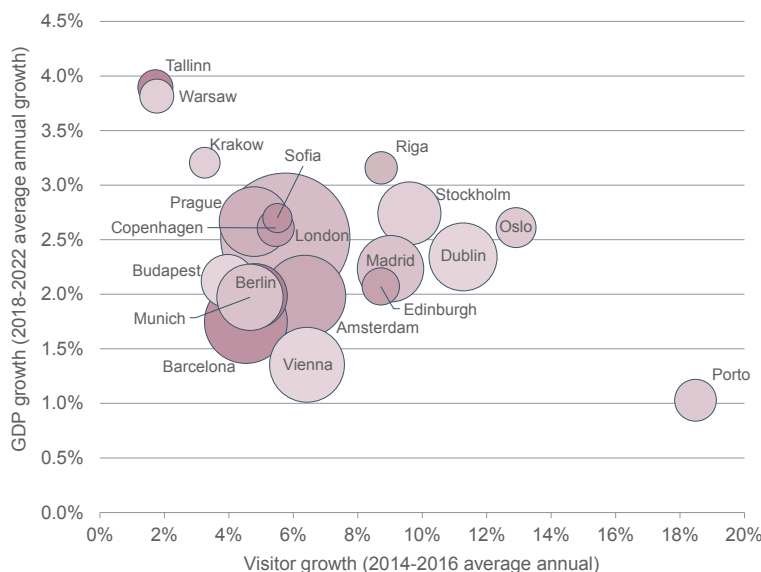
The strength of these new concepts going forward will be determined by their appeal to millennials and post millennials (those currently aged under 21). Global millennial spending power is forecast to overtake that of its older Gen X cohort in 2020, with millennials accounting for 75% of the global workforce by 2025, making them a very important guest demographic.

What makes them even more interesting is that they are a very different cohort than previous generations; they are the first digitally native generation, more demanding favouring flexibility, more environmentally and socially aware and more health conscious.

In response lifestyle concepts have introduced blurred spaces into their properties that align with this demographic, albeit this is less about age and more about lifestyle aspirations. Co-working, event space, F&B and health & fitness all offer a degree of vibrancy particularly where it is possible to incorporate into communal areas such as reception. This blurring is not just about enhancing property attractiveness and operational performance but can also generate additional revenues from under utilised spaces, ultimately improving margins.

The potential associated with these emerging concepts is attracting both developer and investor interest, particularly where there is synergy as part of a larger mixed use scheme.

GRAPH 1
Top 20 opportunity markets



Graph source: Savills Research; Oxford Economics; Official Local Tourist Office Statistics

→ opportunity to tap into both growing leisure and corporate markets.

Despite a comparatively less attractive GDP forecast, Porto's average annual visitor arrival growth of 18.5% creates appeal in regards to a rapidly developing leisure market.

A cluster of more established growth cities is evident from the chart, markets with a larger base GDP level and tourism profile. This includes the likes of Barcelona, Munich, Amsterdam as well as Vienna - which has already been recognised as a target city by a number of the larger extended stay operators. In the case of Barcelona however, restrictions on new hotel development does preclude it from further expansion over the short term.

Smaller visitor markets, but those reporting strong growth with a robust economic outlook, may also prove attractive for expansion. Copenhagen, Sofia, Warsaw and Tallinn all stand out on this basis with many reporting strong hotel operational performance over the last 18 months.

The UNWTO forecast that crossborder tourist arrivals into Europe will increase by 34% by 2030, therefore the ability to tap into this leisure demand will be

key to the growth of the sector. With this in mind, ensuring the concept and branding of sites can traverse both corporate and leisure markets will be vital to expansion.

Are corporate acquisitions the only route to exposure?

At present, in terms of significant exposure for investors, it would appear that it is.

The issue for investors continues to be the lack of purpose built stock. This is improving as operators pursue expansion through new development, with the pipeline likely to throw up potential acquisition opportunities. However, transactional activity remains relatively constrained.

Deal count rose from 19 to 20 in 2017 with volumes in the region of €300 million, with the UK dominating. To date this year there have been seven transactions, albeit volumes are already more than double that of 2017 due to the £430 million acquisition of the SACO portfolio by Brookfield, which included the operational and development parts of the business.

The Brookfield acquisition in some ways has enhanced the legitimacy

of the sector particularly in the eyes of institutional investors. The lower operational costs associated with an extended stay property, relative to a comparable hotel, has been an additional attraction. So too is the diversification potential against the backdrop of increased global travel.

Other examples of corporate activity include Ares reportedly acquiring a 70% stake in Native in 2016 and the Thai family owned Hua Kee taking one-third of Cycas Hospitality in 2017. In the case of the latter deal the funding provides Cycas capital for expansion as well as lining up Hua Kee as a potential co-investor on future deals.

While both acquisitions highlight investor confidence in the sector, it also demonstrates the current difficulty to gain exposure via single asset and real estate only portfolio acquisitions.

Going forward we expect to see further corporate level acquisitions and M&A activity that allow operators to bolster their European coverage. While the larger operators have gained significant ground in developing pan-european portfolios the market continues to be disparate, meaning that there is still everything to play for. ■

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