PRICEWATERHOUSECOOPERS

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Extended stay hotels: a US model whose time has come in the UK?

With the entry of InterContinental Hotel Group's (IHG) Staybridge Suites to the UK hotel market, the extended stay hotel concept that has helped to fuel growth in the US hotel sector in recent years, is now set to enter a new phase in the UK. UK business and leisure travellers to the US may already be familiar with US extended stay brands such as Homewood Suites, Extended Stay America or Residence Inns. Here in the UK a smaller number of business and leisure travellers may recognise brands offering a different model of longer stay accommodation, some more akin to US corporate housing. These include Bridgestreet, Ascott, PREM, Fraser Hospitality and hotel rooms from Club Quarters.

IHG report seven UK development contracts already signed and their trailblazing move into Europe will be watched keenly by others whose owners include many of the major US branded full-service operators. Increasingly, they believe that changes in working patterns and lifestyles mean Europe now represents a potentially fertile market for the extended stay hotel offering, with its combination of longer stays (usually five days plus), simpler premises without bars and restaurants, and low pricing. As room rates continue to soar in many UK cities, alternative accommodation products are increasingly likely to appeal to corporate buyers as a more cost effective way to accommodate some of their travelling workforce.

For operators, investors and developers, extended stay hotels in Europe offer significant potential opportunities and benefits – including relatively low development and running costs, stable revenues and high returns compared to full-service hotels.

Compared to almost 240,000 rooms in the extended stay hotel sector in the US alone, the branded UK sector comprises mainly serviced apartments and residences and accounts for around 3,400 rooms. It remains to be seen whether extended stay as a concept will ever capture the imagination of the hotel customer in the UK or Europe as successfully as it has in the US.

*connectedthinking

What is ‘extended stay’?

Extended stay products: three approaches

Extended stay properties operate under several banners, brands and models, but all share the characteristic of offering guests accommodation for five days or more without the usual additional services of a full-service hotel. They generally fall into one of three categories:

- All-suite hotels;
- Apartment hotels or ‘aparthotels’; and
- Serviced apartments

The concept of extended stay hotels dates back to 1974 when Marriott opened its first Residence Inn in the US. Since then the extended stay model has achieved strong growth in the US. The commonly-accepted definition of ‘extended stay’ in the US market is a hotel with self-catering suites where guests stay for five days or more, but which usually does not offer the ancillary services such as bars, restaurants and porterage provided by full-service hotels.

In the US today, 20 per cent of hotel stays are estimated to be five nights or longer – much of that accounted for by extended stay locations. Customers are mainly business travellers and include employment categories such as construction workers. The healthy growth in the extended stay sector has been driven by the geographical size of the US, and demand among travellers staying away from home for more ‘homely’ and value for money accommodation than the full-service hotel. The trends towards secondments and more flexible use of human capital have further strengthened demand. As the extended stay market has grown and become more sophisticated in the US, it has segmented into budget, mid-tier and upscale offerings.

“This segment directly responds to the one out of five travellers staying five or more nights seeking larger units and kitchen facilities. Extended stay hotels are including many of the amenities of the industry in general such as flat screen televisions and wireless internet access, and more choice of service levels and price points especially with the newer brands”

Bjorn Hanson, Ph.D. PricewaterhouseCoopers LLP

Not a significant feature in the UK – yet

Table 1 Selected UK Operators of transient and extended stay products (including apart'otels, serviced apartments)			
Company	**Serviced units/apartments/keys**	**Product/Brand**	**UK Locations**
Bridgestreet Worldwide (Sorrento Structuring)	1,000	By Bridgestreet	London, Manchester, Birmingham and Leeds
Ascott Group (CapitaLand)	848	Ascott Residence, Somerset, Citadine Apart'otels	London
Frasers Hospitality	365	Fraser Suites, Fraser Place, Fraser Corporate apartment	Glasgow and London
PREM Group	318	Premier Apartments	Bristol, Birmingham, Liverpool, Nottingham, Manchester, Newcastle
Club Quarters	756 rooms*		London
Marriott	47	Marriott Executive Apartments	London
Total	**3,334 units**		

*__Note:__ Including 57 corporate apartments
Source: PwC from brochures, interviews and websites February 2007

In the UK to date, the extended stay market has tended to remain relatively small-scale, fragmented, unbranded and upscale. But while extended stay hotels have not been a significant element of the UK's hotel landscape, Table 1 shows a snapshot of some of the current operators and their brands, accounting for around 3,400 units or keys.

With 1,000 units, BridgeStreet Worldwide is the UK's largest operator. It is a leading serviced apartment provider with over 20 years' industry experience and has continued its growth within the UK with the recent opening of new properties in London, Leeds and Birmingham, offering high quality accommodation for travellers seeking independence, privacy and security.

> *"As well as offering more space at lower rates than a traditional hotel, we have tailored our offering to the needs of regular travellers with a minimum one-night stay. Our clients trust BridgeStreet to deliver attractive and comfortable apartments with the latest amenities on demand."*
>
> Jo Layton, Director of Sales and Marketing[1]

The Ascott Group is the largest international serviced residence owner-operator outside the United States with about 19,000 serviced residence units in key cities of Asia Pacific, Europe and the Gulf Region. In the UK Ascott operate 848 units under three brands – Ascott, Somerset and Citadines.

Irish PREM Group has 300 units under their Premier Apartment banner in key locations in the UK, with more in the pipeline. Their apartments are largely established outside London and many are at the high end of the market, with most demand coming from corporates.

Frasers Hospitality, a Singapore based and internationally branded serviced residence management company has 365 units under its Fraser Suites, Fraser Place and Fraser Corporate Apartment banners in Glasgow and London. Among international hotel operators, Marriott provides its Executive Apartment offering in four selected locations in Europe including London's Canary Wharf, but has not revealed any plans to roll out its US extended stay brands in the UK.

A slightly different approach comes from another stylish product, Club Quarters. The company has nine hotels in the US and three properties in London and targets corporate account holders, although leisure travellers can now stay weekends. They target transient as well as extended stay travellers and have recently added some 57 corporate apartments to their hotels in London. Other operators in this space include Saco Apartments, Go Native, Select Apartments, and Oakwood Apartments.

1 ENP Newswire1 September 2006

The invasion begins?

Is the extended stay hotel model established in the US now set for a push on this side of the Atlantic? Having established successful and profitable extended stay brands in the US, some hotel players are considering targeting Europe and the UK in particular.

In 2005 Staybridge Suites, an extended stay brand owned by IHG, became the first to launch a European development strategy. Unusually for a hotel brand entering a new market, it plans to grow the business by using a management contract and franchising model. At the time of writing John C. Wagner, Vice President Staybridge Suites-EMEA, has told us that seven development contracts have been signed and several more will follow soon.

> *"The UK's first Staybridge Suite is scheduled to open in Liverpool in the first quarter of 2008, and we aim to have between 20 and 25 operating or under development in the UK by 2010. We intend to extend the brand to continental Europe once the UK bridgehead is secured."*
> John C. Wagner Vice President Staybridge Suites-EMEA 2007

The company's search for development and investment partners has seen its model attract interest both from within and beyond the traditional hotels development and franchising sector. The parallels between extended stay and residential mean that developers with a strong background in residential properties are also interested in participating in extended stay opportunities – potentially opening up the potential for the hotel industry to get involved with a whole new segment of the development community.

Other US-based players are also reported eyeing a move into Europe, but are less advanced in their planning. Marriott and Starwood have indicated a desire to develop their offerings further, but have yet to reveal firm plans. And Hilton's Homewood Suites is known to be considering Europe, but also has yet to show its hand.

> *"We feel any market where you can have an economy of scale quickly, like the UK, makes sense."*
> Rebecca Wyatt, Senior VP brand management for Homewood Suites[2]

STAYBRIDGE SUITES

HOMEWOOD SUITES Hilton

2 BTNonline January 22 2007

Why the UK – and why now?

Several drivers are at work behind the growing interest in extended stay in the UK. Some of these factors reflect changes in the demand profile of the marketplace in the US and Europe, while others reflect the internal dynamics of the hotels industry, including strong demand and room rate gains in the UK's key cities, especially at the luxury end. The growing interest in this sector can be summarised as follows:

• A more mobile workforce

Secondments are increasingly common between the operations of global corporates within Europe and other parts of the world. Extended breaks between jobs, sabbaticals and working holidays are also popular. Firms such as PwC are seeing more people on client work travelling within the UK for two weeks to six months at a time. Whilst hotels have been used in the past, many travellers are now looking for larger rooms, flexibility to cater for themselves, modern appliances and high speed internet access. A hotel may not have the required flexibility and adding on the extras can prove very expensive for the budget holders.

On the demand side, European work and business travel patterns are shifting towards the US profile. Business travel is at an all-time high, and also, as the EU enlarges and the European economy becomes increasingly integrated, the geographical size that has helped extended stay in the US is starting to come into play in Europe.

• An increased awareness of alternative hotel products

The UK market has been predominantly driven by hotels with few options whereas now companies like BridgeStreet, Marriott ExecuStay, Ascott, Club Quarters and Citadines are entering the market and providing a high quality alternative.

• Cost control

Increases in hotels rates is driving corporate buyers to look elsewhere. Some apartment providers offer one night stays from £90 per night which undercuts the average four star hotel in London significantly. PricewaterhouseCoopers research highlighted in our latest UK Hotel Forecast for March 2007 shows average room rates in London passed £116 in 2006 and topped £350 in the luxury sector.

> *"The improved extended stay product appeals to corporates who are concerned about employee welfare. This also plays into many firms' Corporate Social Responsibility (CSR) policies."*
>
> Samantha van Leeuwen, Head of Hotels, Procurement and Venues, PricewaterhouseCoopers LLP

In terms of the supply-side factors, international hotel operators are looking to Europe and Emerging Markets to capitalise on perceived growth opportunities in general and the limited current availability of branded extended stay products. One driver is that extended stay hotels represent an increasingly mature industry sector in the US, prompting operators to look elsewhere.

Despite rising inventory, rates in extended stay hotels rose by 9.9 per cent in 2006 against an average of 7 per cent for the US hotels sector as a whole, according to The Highland Group. Average rates for extended stay hotels in the US are now at record rates in all three tiers – although many of these are low in comparison to traditional hotels. Overall extended-stay average daily rate in the economy segment was $33.67 in 2006 and $63.24 in the mid-price sector.[3] Despite low rates the sector generates Gross Operating Profit ratios above the industry average and this makes the sector popular with developers and owners.

Data from Smith Travel Research show that extended stay hotels account for around 5.3 per cent of all rooms and 3.8 per cent of all hotels in the US. Much of this supply is in the budget and mid-priced sectors.

Extended stay's economic edge

With the conditions and timing appearing favourable in Europe, the attractiveness of the extended stay model for operators, developers and investors is compounded by its economic efficiency, both in terms of initial market entry and ongoing operations.

The benefits begin with the significantly lower development and construction costs of extended stay premises. They are fundamentally simpler buildings than full-service hotels, with no need to design and build large common areas or bars, restaurants and kitchens. There is also less need for an impressive foyer and high-profile (and therefore probably expensive) location. The impact of all these factors on costs is dramatic. According to Staybridge, the development costs per key – excluding land, site preparation and fees – for an extended stay facility are around £80,000 to £85,000 per key, compared to David Langdon Everest's estimate of £100,000 to £140,000 per key for a full-service hotel in a provincial UK location. There are also opportunities to use modular construction techniques, thereby reducing time and cost and helping to ensure a standardised product.

The cost base remains lower once the hotel is operational. Payroll costs are significantly reduced due to the less intensive levels of service and the lack of substantial food and beverage outlets. Generally the longer the stay the lower the room servicing costs, with some properties only servicing rooms on request or at check-out time. Property operations and maintenance costs also tend to be lower than in full-service hotels. In addition, in areas such as housekeeping, the general level of finish is lower than in a hotel and there are no flowers etc to replace each day. Yet, on the upside, occupancy rates are generally higher because of the greater forward visibility and lower levels of daily turnover.

In combination, all these factors flow through to superior profitability ratios, with industry estimates putting gross operating profit at about 50 per cent of revenues, compared to a target of around 35 per cent to 40 per cent

Extended stay hotels account for 5.3 per cent of all hotel rooms in the US

Existing Statistics	Hotels	Rooms	Pipeline Statistics	Hotels	Rooms
Extended Stay	1,856	239,401	Extended Stay	333	38,578
Total US	48,871	4,494,710	Total US	4,806	536,973
Extended Stay Percentage	3.8%	5.3%	Extended Stay Percentage	6.9%	7.2%

Source: Smith Travel Research. Source: Smith Travel Research.

3 The 2007 US Extended Stay Lodging Market, The Highland Group, 2007

for a well-performing full-service hotel. Extended stay also tends to have a shorter stabilisation period than full-service hotels of comparable quality, with more predictable revenues owing to greater forward visibility over bookings. This makes extended stay especially attractive to longer-term investors, providing more stable returns even under management-style contract arrangements.

Robust but flexible

Aside from these advantages, further economic benefits of the extended stay model include its flexibility and ability to withstand economic downturns. Experience in the US suggests that while full-service hotels are highly exposed to economic cycles, extended stay benefits from a recessionary 'hedge' because companies that lay off workers tend to then make more use of temporary and contract staff or secondments – which in turn boosts demand for extended stay accommodation.

As regards economic flexibility, in the event of a severe downturn an extended stay operator will often have the option of switching to a more traditional one-night-stay or transient model to sustain revenues – something traditional serviced apartments generally did not do, although this may be changing. For those that can't, this is because some countries, and centres such as London, require serviced apartments to meet a minimum stay requirement, which are dictated by the planning requirements for residential use. By having their developments classified as hotels for planning purposes, new entrants to the UK extended stay market gain a technical trading advantage because of the greater flexibility to accept shorter stays that this allows them.

Extended stay's hybrid nature – already attracting UK developers with residential rather than hotel experience – also suggests there is potential for new and flexible approaches to financing, ranging from residential developers themselves to high net worth individuals and even quasi-private equity players. The UK's recently-created listed REITs – real estate investment trusts – may also play a role, perhaps heralded by Land Securities' recent move to buy the real estate of Novotel in the UK from Accor.

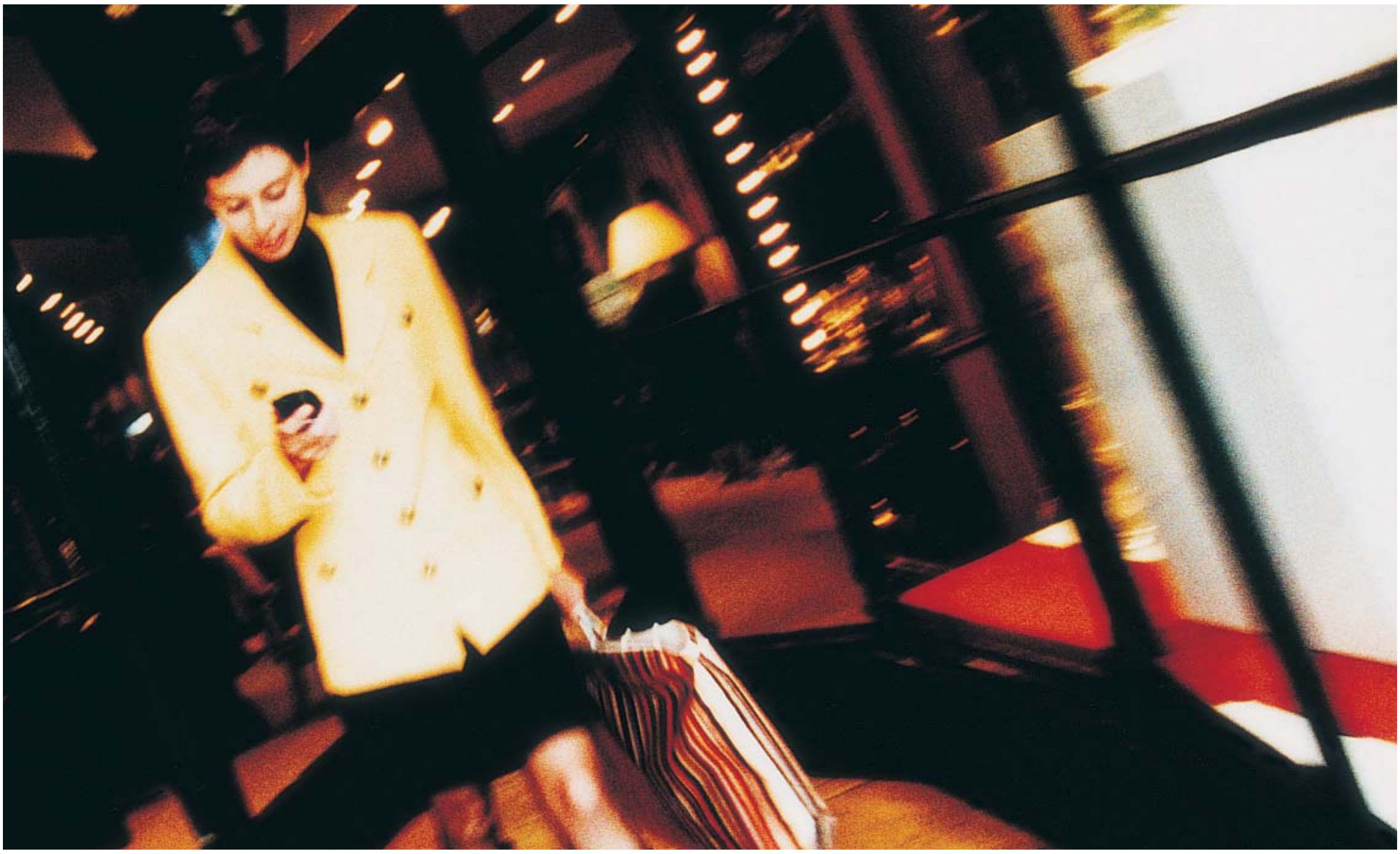
Going forward: the outlook for extended stay in Europe

The signs are that the UK's well-established serviced apartments sector is about to be joined by a new competitor, branded extended stay hotel offerings. Potential extended stay hotels' lower build costs and higher operating margins compared with full-service hotels, coupled with the availability of an experienced manager via a management contract, is likely to attract interest both from hotel and non-hotel developers.

The key to extended stay's future prospects – and to its impact on the UK and eventually European hotels industry – lies in the benefits it offers to each element of the hotel development and operation value chain. For each participant, the implications of extended stay include:

- For **owners, developers and investors** – lower operating and development costs, lower risk and higher returns.
- For **corporate buyers** – a better and newer product, potentially at a lower cost.
- For **consumers** – A wider choice of flexible product when seeking somewhere to stay.
- For **existing extended stay and serviced apartment operators** – Increased high-profile branded competition benefiting from the advantages of branded hotel distribution systems.
- For **the full-service hotel sector as a whole** – An increase in high quality attractively priced competition.

Some in the industry are asking whether IHG has jumped the gun, pointing to the UK's relatively small geographical size, which makes it easier for people to get home than in the US. Nevertheless, interest in alternative value products is growing. What is beyond doubt is the committed way in which Staybridge Suites is entering the market. If it performs well, others will undoubtedly follow.



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