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HERE TO STAY

AN OVERVIEW OF THE EUROPEAN SERVICED APARTMENT SECTOR

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We would like to sincerely thank the owners, operators, lenders and investors who contributed to this article and appreciate their time and input.

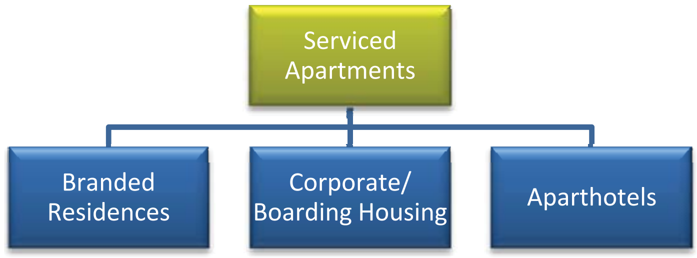
Introduction

This report gives an overview of the European serviced apartment sector. Having spoken with industry professionals, we have divided serviced apartments into three sub-categories: branded residences, corporate/boarding housing and aparthotels (see Figure 1). In the report, we explain each one, with particular emphasis on aparthotels. We also highlight the trends, opportunities and challenges the sector faces. Lastly, having spoken with several banks and investors, we give an overview of the general investment environment and appetite for serviced apartments.

Serviced Apartments

Serviced apartments are a hybrid of two different asset classes: the residential apartment sector and the hotel market. Their aim is to fill the void between a short hotel stay and longer-term rental accommodation. Despite still being a relatively unfamiliar concept to both investors and customers in Europe, the industry is growing and is now making its way onto the radar. One of the keys to its success is being able to generate a higher gross operating profit and net operating income than the average hotel. This is achieved through lower guest turnover because the length of stay is longer than that of normal hotels and lower operational costs achieved by providing fewer and less frequent services. Not only is this structure attractive to both investors and operators, but it is also a particular advantage in more challenging economic times and can give serviced apartments a competitive edge over the conventional hotel product.

FIGURE 1 THE THREE TYPES OF SERVICED APARTMENTS



While there is no official definition, we consider the term 'serviced apartment' to be an umbrella term that can be broken down into three sub-categories: branded residences, corporate/boarding housing and aparthotels. Figure 2 gives a broad comparison of the three sub-categories.

Branded Residences

Even though the concept of branded residences is not new, it has, over the past ten years, rapidly evolved globally. Branded residences are an amalgam of a typical real estate investment grouped with the elusive concept of 'lifestyle'. They tend to fall into the upscale and luxury category and attract cash-rich and time-poor individuals who are constantly globetrotting and enjoy having their 'home' looked after.

Branded residences are characteristically managed by well-known hotel operators, such as Ritz-Carlton, Four Seasons or Jumeirah, and are therefore usually located adjacent to a hotel. This allows the resident owners to benefit from the use of hotel services, facilities and amenities. Recently, however, residents are demanding much more than simply the enjoyment of hotel services and facilities. Wealthy consumers are craving art and design, which has allowed high-end fashion labels, such as Bvlgari, Armani, Versace and Missoni to enter the market.

FIGURE 2 OVERVIEW OF SERVICED APARTMENTS

Characteristics	Branded Residences	Corporate/Boarding Housing	Aparthotels
Average Length of Stay	Depends	30 days – 2 years	2-5 days
Facilities	*En Suite* Bathroom, Full Kitchen, Lounge/Dining Area, Work Area/Desk, In-Unit Laundry	*En Suite* Bathroom, Full Kitchen, Lounge/Dining Area, Work Area/Desk, In-Unit Laundry	Kitchenette, *En Suite* Bathroom, Lounge/Dining Area, On-site Laundry
Services	All Services Offered at the Hotel upon request/at extra charge	Potentially a Concierge, Weekly Cleaning	Reception Desk (24-Hour), Weekly Cleaning

Source: HVS Research

FIGURE 3 BRANDED RESIDENCES: NEW SUPPLY

Country	Name of Property	Operator	Opening Date
UK	W Residences, London	W Hotel	2013
	The Shard London	Shangri-La	2013
	Bvlgari Residences	Bvlgari	2013
Switzerland	The Chedi Andermatt	GHM	2013
	W Residences Verbier	W Hotel	2013
	InterContinental Residences, Davos	InterContinental	2013
	Du Parc Kempinski Private Residences, Mont-Pelerin	Kempinski	2013
	51 Degrees, Andermatt	To Be Confirmed	2015 (Phase 1) 2016 (Phase 2)
Turkey	Fairmont Residences Quasar, Istanbul	Fairmont	2016
	The Residences at Mandarin Oriental, Bodrum	Mandarin Oriental	2013
	The Residences at Viceroy Bodrum	Viceroy Hotels & Resorts	Under Development
Austria	The Residences at the Hotel Sans Souci Vienna	Sans Souci Hotels & Resorts	2013
Montenegro	Regent Hotel & Residences, Porto	Regent	2014
Italy	Grand Hotel des Bains, Venice	To Be Confirmed	On hold
	Palazzo Tornabuoni, Florence	Four Seasons Hotels & Resorts (managed only)	2012/13*

Note: This list is not exhaustive

*Completed four/five years ago – now the residences are for sale

Source: HVS Research

Branded residences are usually located in international city centres, as well as in resort destinations. When they are located in prime holiday destinations, they often target the ultra-rich by including even more astonishing features. For example, the 51 Degrees in Andermatt, Switzerland, will provide each of its residential units with in-home access to thermal water.

The strong growth in branded residences has been spurred by its attractiveness to both developers and investors. Compared with unbranded residential properties, developers of branded residences can demand premiums of between 10% and 50% in the main key cities around the world, according to the latest research by Knight-Frank. What drives this premium is innovation in terms of concept (a mix of hotel rooms and residential investment), the convenience of onsite services, design and security of buying into a brand. Similarly, investors see branded residences as a relatively safe investment as it is a tangible asset attached to a well-known luxury hotel brand. Moreover, investors are attracted by the design and the high-quality services associated with the concept.

In some cases, particularly in resort destinations, some brands offer rental management agreements, providing a turnkey investment opportunity. In this case, the branded residence is then purely an investment product and the owner of the unit will have restricted use. This type of scheme is usually not in place for ultra-luxury properties in gateway cities.

Figure 3 gives an overview of some of the recently added and new supply throughout Europe.

Corporate / Boarding Housing

Corporate housing is a product that resulted from the short-term apartment rental market. It facilitates the stay in residential-like accommodation for periods of typically anywhere between 30 days and two years, and therefore provides a 'home-away-from-home'. It smoothes the process of finding an apartment abroad, dealing with rental contracts and all of the other administrative work related to acquiring a temporary home.

ADAGIO

The corporate housing concept is therefore particularly successful in areas where residential vacancy is low and it is difficult to find short-term lets.

Corporate housing is used for relocations, business assignments, as a temporary home during remodelling, when attending courses/education or by the military. Many corporate housing companies have a flexible number of units with short-term leases, allowing them to increase or decrease the number of units based on demand. These apartments are usually furnished, with a fully equipped kitchen, bedroom, living and working area, and function as regular apartments in that almost no services are provided. Therefore, skeleton staffing is in place, allowing the underlying business model to achieve high profit margins.

Many cities and countries have established legislation to regulate the corporate housing market, such as enforcing a minimum 30-day rental period. This is to avoid disruption in residential buildings, where some residents live permanently, as well as to protect hotels and short-term operators.

Oakwood, BridgeStreet, Fraser Suites and Marriott Executive Apartments are some of the larger players in Europe. The market, however, is still dominated by individual property owners, and we thereby see a huge opportunity for consolidation. For example, in the USA in 2012, Oakwood bought ExecuStay from Marriott and National Corporate Housing acquired Equity Corporate Housing from Equity Residential.

ADINA HAMBURG

The corporate housing market, in particular, struggles to define its place in the hotel industry in terms of product and experience. While conducting our research, we came across the following terms that refer to the same concept: corporate housing, boarding housing, furnished rentals, vacation rentals and even serviced apartments.

Aparthotels

Of the three sub-categories, aparthotels most resemble the hotel concept. Some individuals refer to aparthotels as extended stay hotels, while in reality the average length of stay in Europe is only a day or two above that of a conventional hotel. What differentiates aparthotels from hotels is their kitchenette or kitchen and slightly more spacious rooms. Additionally, unlike in hotels, fewer services are provided. Cleaning, for example, usually occurs weekly rather than daily (unless at an extra charge) and all-day-dining facilities are not always provided, although breakfast often is. When a client does require additional services, most aparthotels can provide them for a fee.

FIGURE 4 APARTHOTELS: NEW SUPPLY

Opening Date	Brand	City	Country
2013	StayCity	London (Greenwich)	UK
	StayCity	Cardiff	UK
	Adagio	Cologne	Germany
	Adagio	Liverpool	UK
	Base2stay	London	UK
	Citadines	Paris	France
	Residence Inn by Marriott	Edinburgh	UK
	Citadines	Paris	France
2014	StayCity	Lyon	France
	StayCity	Marseilles	France
	StayCity	Rome	Italy
	Element	Frankfurt (Airport)	Germany
	Citadines	Hamburg	Germany
	Citadines	Frankfurt	Germany
	Capri by Fraser	Frankfurt	Germany
	Cheval Three Quays	London	UK
2015	Ascott St James (ex-Cavendish)	London	UK
2016	Element	Muscat	Oman

Source: HVS Research

The pricing strategy for aparthotels is similar to that of hotels, as prices tend to fluctuate daily. However, owing to slightly longer stays, pricing is regressive in function of the length of stay,

FIGURE 5 APARTHOTELS: EXISTING SUPPLY

Company	Brand	Number of Properties	Location
Accor (Pierre & Vacances)	Suite Novotel	27	Austria (1), France (19), Germany (4), Luxembourg (1), Spain (1), Switzerland (1)
	Adagio	86	France (74), Austria (1), Belgium (2), Germany (3), Italy (2), Monaco (2), Switzerland (2)
	Adagio Access	89	UK (1), Germany (3), Belgium (2), Austria (1), Switzerland (2), Italy (2), France (78)
Ascott Group	Ascott	3	France (1), UK (2)
	Citadines	40	Belgium (2), France (30), Germany (2), Spain (1), UK (5)
Derag	Derag Aparthotels	11	Austria (1), Germany (10)
Fraser Hospitality	Fraser Suites	9	France (2), UK (4), Qatar (1), Saudi Arabia (1), Bahrain (1)
	Fraser Place	2	UK (1), Turkey (1)
	Fraser Residences	6	UK (5), Hungary (1)
Marriott	Residence Inn	2	Germany (1), UK (1)
Orca Group	MaMaison	5	Slovakia (1), Czech Republic (1), Poland (1), Hungary (1), Russia (1)
StayCity	StayCity Apartments	8	France (1), The Netherlands (1), UK (5), Ireland (1)
Toga Hospitality	Adina	7	Denmark (1), Hungary (1), Germany (5)
Premiere Group	Premiere Apartments	8	UK (7), Ireland (1)
Go Native	Go Native	763	UK (763)

Source: HVS Research Note: This list is not exhaustive

meaning that the longer an individual books, the lower the price will be on a per night basis. Additionally, aparthotels are often slightly more affordable than full-service hotels since they only provide limited services. The low operating cost structure permits this type of pricing.

The Association of Serviced Apartment Providers (ASAP) has revealed that some of the main drivers of aparthotels include price, the option to self-cater and space. Our interviews revealed similar factors and illustrate that, owing to the value for money, this type of product is particularly attractive during times of economic uncertainty, where corporate budgets are cut and leisure spending has decreased.

Figure 4 gives an overview of the new supply. This list is not exhaustive.

The Major Players – Aparthotel

There has been significant movement in Europe in the aparthotel sector over the past ten years. Multiple new, large, international brands have entered the European market, such as Residence Inn by Marriott (2011) and Element; we have also witnessed a number of rebrandings, such as Suitehotel to Suite Novotel.

Marriott recently successfully entered the European and Middle Eastern markets with three hotel openings in 2011: the Residence Inns in Munich, Edinburgh and Manama. We understand from Marriott that the Residence Inn brand will grow through management (30-40%) and franchise (60-70%) agreements in Europe.

Accor is already a large player in Europe, the Middle East and Africa with its Suite Novotel and Adagio City Aparthotel brands. Suite Novotel is a midscale brand which currently operates over 30 hotels in the EMEA region. The brand was originally known as Suitehotel, but was rebranded in 2010 to take advantage of Novotel's well-established marketing and distribution network.

Adagio City Aparthotel is a joint venture with Pierre & Vacances. The brand is positioned in the three- to four-star segment and the hotels are typically in city centres. Similar to Suite Novotel, they have a large brand presence in France, but also have hotels throughout continental Europe and northern Africa. Adagio plans to enter the Middle Eastern and UK markets in 2013 with the opening of hotels in Abu Dhabi and Liverpool.

The Ascott Group has a European presence with all three of its brands. It recently acquired The Cavendish Hotel in London for £158.8 million and began its management in the last quarter of 2012; Ascott plans to rebrand the hotel under the name Ascott The Residence. This acquisition has increased the

FIGURE 6 OVERVIEW OF THE MAIN SERVICED APARTMENT BRANDS

company's London portfolio to seven hotels. We note that many of the London Citadines Prestige properties have recently undergone a renovation and are in very good condition.

Fraser Hospitality, the hospitality arm of Fraser & Neave, operates Fraser Suites, Fraser Residences and Fraser Place in Europe and the Middle East. Unlike Fraser Residences, where the minimum length of stay is 30 days, Fraser Suites is an extended stay product with no minimum stay requirement. Fraser Place acts as a hybrid between the two. It has apartment-style rooms with fully equipped kitchens, perfect for long-stay guests, but does not have a minimum stay requirement.

The Mamaison All-Suite Residences are primarily located within Eastern Europe. Mamaison still sees much potential in this part of the world and will remain focused on this region. Mamaison caters to both short- and long-stay guests.

Adina, part of the Australia-based Toga Hospitality Group, has been operating in Europe for about eight years. Its first property in the region (Adina Apartment Hotel Budapest) was a franchise, while all of its other properties are owner-operated. Adina is looking to strengthen its foothold in Germany and plans to enter the UK and potentially France and Spain as well.

StayCity, Permier Apartments, Go Native and Base2Stay/Nadler are currently primarily UK and/or Ireland based. Some of these brands are also interested in expanding into continental Europe should the opportunity arise. SACO apartments, which originated in the UK, has been very successful at expanding into mainland Europe. Other companies highlight that there is still a lot of potential to grow and expand in the UK, particularly in London.

Figure 5 gives an overview of the supply previously discussed, and Figure 6 depicts the main serviced apartment brands by category. We note that neither table is exhaustive.

Trends, Opportunities and Challenges

Positive Shrinking

The ongoing economic crisis has significantly changed the way we travel, as corporate travel budgets have shrunk and everyone is acting a bit more frugally. So what is the millennial extended stay traveller looking for? Value, simplicity and affordability. This doesn't exactly fit in with the soaring rental prices that many cities, including London, are exposed to, causing price-sensitive travellers to be locked out of city-centre metropolises where they are conducting business to look for cheaper accommodation in the outskirts of cities and towns.

Guests are willing to give up space in order to pay less. They are looking for smaller and cheaper apartments that still contain all of the necessities, while simultaneously creating an illusion of space. That is one of the reasons

MULTI-FUNCTIONAL SPACE

MAMAISON RESIDENCE BELGICKA

why hotel brands that follow this trend closely, such as CitizenM and Yotel, are so successful as hotel concepts.

Serviced apartments initially benefited from the economic crisis, as business travellers who would otherwise stay in hotels moved to extended stay products as they often offered cheaper prices owing to their lower-cost business model when compared to hotels and especially long stay where prices are more negotiable. However, as the recession dragged on, serviced apartment operators and owners realised that they too must adapt to the smaller budgets and offer prices that are more competitive. How have they done this? Many new extended stay properties offer slightly smaller rooms or include more studios and one-bedroom units in the overall mix, which have allowed pricing to come down, which has been positively accepted by guests. We have already seen a trend for aparthotels to increase the number of studios. However, can this shrinking be taken to another level?

We consider that this urge to downsize is just beginning and can be taken further. Micro apartments, as they are referred to, can provide eco- and budget-friendly living in about 20 m^2. Despite the small size of these apartments, designers have been inventive in finding new ways to create an illusion of space by designing triple functionality space, whereby one single room can function as a dining room, living room/office and bedroom. How is this accomplished? With high ceilings, retractable beds, foldaway tables and so on.

Growth in Europe

We are often asked the question 'Why has the serviced apartment market not taken off in Europe?' There are multiple aspects to consider. First, the serviced apartment concept is relatively new in Europe. This makes it hard for developers such as IHG and Marriott to find financing for projects and limits their ability to expand through franchises and/or management agreements. In order for them to launch their brands, and to expand at a faster pace, the operators would have to use their own funds to show the profitability of such an investment. However, asset-light strategies often prohibit such expansion. We consider this an unwise strategy; the development of company-owned reference sites in each country should enable expansion of such a brand at a much faster rate.

Secondly, distance plays an important role in the slower growth of the serviced apartment market. In the USA, the distance between the East and West Coast is about 4,800 km, which equates to a five-hour plane ride. This makes it almost impossible to fly home to the East Coast for the weekend while working on a project in California. Flying from London to Berlin, however, is only about 1,000 km with a flight time of 1.5 hours and can easily be done in a day. Hence, the trend for individuals working on projects in Europe is to return home more frequently, whereas business people employed on projects in the USA have a harder time returning home as often. This makes the extended stay market much larger and more profitable and gives US properties a unique advantage over European properties where mobility is increased owing to shorter distances. This has caused the European extended stay product to adapt to shorter lengths of stay, when compared with US properties.

FRASER PLACE CANARY WHARF

Barriers to Entry

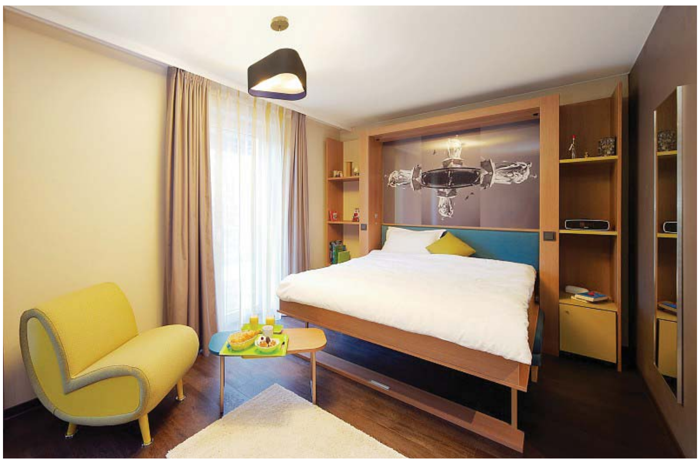
Planning and zoning issues are another major hurdle for the extended stay market. Our interviews revealed that many mixed-use developments, for example, consider the inclusion of a hotel and/or apartments, but do not tend to entertain the possibility of having onsite serviced apartments. Therefore, additional discussions with the local planning authorities might be necessary.

Secondly, many cities impose minimum-length-of-stay regulations on serviced apartments so that they do not compete with hotels. For example, in some parts of London serviced apartments are only allowed to rent out rooms for more than 30 days. This makes it difficult for the expansion of aparthotels, as their length of stay often averages no more than three to five days.

In high-demand periods, many apartment owners contemplate renting out their domestic apartment for short lets. This can be an infringement of the planning regulations because a registered domestic apartment is prohibited from being let for less than 90 days at a time, which would potentially be the case for short-term lets or hotel-like use. These types of regulations are not likely to change unless there is reliable evidence for a lack of supply for short-term accommodation.

Serviced apartments have also competed with residential developments. Since, historically, many of the involved stakeholders have not completely understood this sector, they chose to develop residential units rather than serviced apartments, as the former are known to be a relatively safe investment that can be easily managed.

ADAGIO



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The Need for Clarification

The serviced apartment industry faces profound challenges in regards to clarity and understanding, primarily due to (1) its nascent entry into the European market and (2) its fragmented nature. As the first point indicates, this relatively new concept remains blurred as guests, investors and lenders do not yet fully understand the concept and therefore do not know what to expect. This lack of clarity is damaging because often apartment users expect similar levels of service as in hotels, which is not likely to be the case.

In addition, the industry remains very fragmented. When avid extended stay guests use serviced apartments in different cities, they often leave disappointed, as inconsistencies between products tend to be considerable, even in some of the branded portfolios. Therefore, it is critical for the extended stay industry to develop classification and accreditation schemes to create a more consistent and homogenous product, which will help to educate the end user. This will also help to foster more interest from developers and lenders as operating performance can be more easily compared and benefits thereby become clearer.

FIGURE 7 TRANSACTIONS IN EUROPE (€)

Date	Property	Room Count	Price	Price per Room	Buyer	Seller
Sep-12	Madison Hamburg	166	37,500,000	226,000	Ascott	AXA Immo Select
Jul-12	The Cavendish, London	230	200,000,000	870,000	Ascott	Ellerman Investment (HNWI)
Mar-12	Suite Novotel Hamburg City	186	18,000,000	97,000	Deka Immobilien	iii-Investment
Apr-11	Citadines Messe Frankfurt	165	28,000,000	170,000	Ascott	GBI Erlangen
Jan-11	Citadines St Michaelis	128	19,800,000	155,000	Ascott	GBI Erlangen

Source: HVS Research

Investment and Financing

As in many other industries, the rocky economic climate that characterised the past few years has also impacted the serviced apartment market. In 2008 and 2009, development significantly slowed and many new projects were put on hold. As the economy showed signs of growth in 2010, the few investors in the market focused on havens such as London, but many times debt finance was not available.

Growth will continue to be hindered while the sector is not fully understood by the financial and investment community. Lenders, for example, seem to be reluctant to provide debt to a sector that lags behind the hotel business in terms of prominence and understanding. The sector remains extremely fragmented and the brands that are established in the market can have inconsistent portfolios. There is also a dearth of reliable, consistent and extensive operating data which can be used to benchmark the sector's performance.

Recently, however, we note that both lenders and investors have shown interest in the sector on account of the lower operational cost structure and potential for a large profit margin. The extended stay sector is relatively robust, which makes for an interesting investment. Despite the fact that many banks have not yet fully immersed themselves in such investments, we understand that large banks (Barclays, HSBC, Lloyds) provide financing to the sector and consider serviced apartments to fall in the same category as hotels when it comes to lending. However, serviced apartments still form a relatively marginal part of the overall hotel portfolio, as for every serviced apartment proposition, banks tend to have around a dozen hotel deals in the pipeline.

If banks do decide to finance a serviced apartment deal, their decisions are primarily based on:

1. Location;
2. The management capability;
3. The contracts and dynamics/performance of that individual asset.

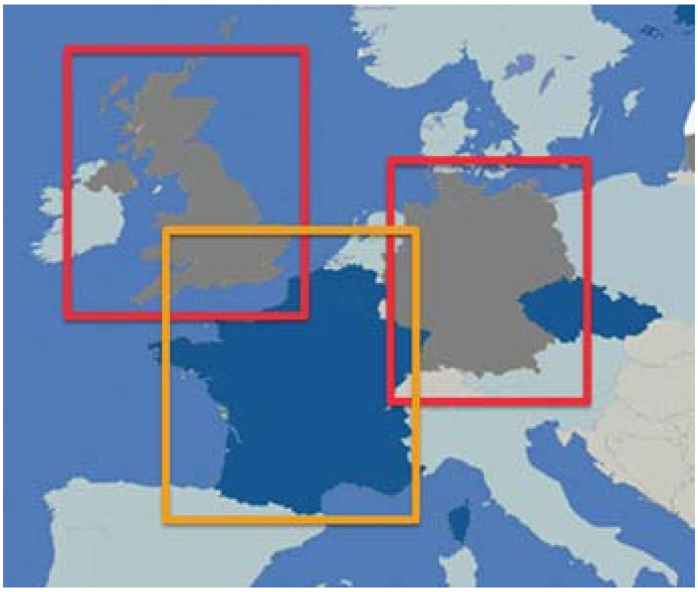
Unlike hotels, where the brand strength is often a deciding factor for securing debt, the potential inconsistency of the serviced apartment product is not a convincing aspect for a deal to take place.

Investors in the extended stay market include private equity funds, high-net-worth individuals and sovereign wealth funds. Many of these organisations and individuals come from the Middle and Far East. A recent example includes the deal between Far East Orchard (FEO) and Toga Hospitality, whereby FEO will invest US$225 million to take a 50% stake in the Toga venture; together, the pair plan to use the venture as a platform to create a new force in the local accommodation market. Many investors are simply interested in getting their foot in the real estate market and view serviced apartments as a similar investment to residential. Noticeably, there is an absence of institutional investment in the sector, which for the main part can be explained by the absence of a critical mass of consistent product and portfolio investment opportunities.

Aside from London, and to some extent other markets in the UK, extended stay owners and operators are showing interest in expanding into Germany and France as they feel that those markets are more mature and the end users understand the product better and hence demand potential is more pronounced.

Since 2009, there have been relatively few recorded transactions in the extended stay

EXPANSION MARKETS



sector. In Figure 7, we highlight five sales that have occurred over the past five years. We note that Germany has been by far the most active market in terms of transactions, and Ascott is currently a dynamic buyer.

Outlook

Owing to its nascent stage in the business cycle and its fragmented and underdeveloped nature within Europe, there exists great potential for future consolidation and development of the serviced apartment sector. Despite the ongoing challenges in Europe, the serviced apartment market has shown continuing, albeit small growth, which reflects the growing demand for the product.

Additionally, as mobility improves, people will continue to travel more to different parts of the world, making serviced apartments a highly attractive consideration for business people and relocating employees who may only be in that city for a limited amount of time.

Large hotel chains have also recently ventured into the extended stay market. Many consider that, as their brands expand and grow, consumers will better understand the product, which will help to drive growth.

However, the industry still faces some profound challenges, primarily because it remains very fragmented. The sector is characterised by lots of individual operators, some with very little product to offer. This leads to a lack of clarity. On a macro level, investors and financiers don't understand the product and/or the market, while on a micro level, guests often do not know what to expect owing to product and service level inconsistencies, which add to the overall lack of clarity and understanding.

Despite the hurdles, there has been general optimism in regards to the future of the serviced apartment sector in Europe. We consider the trend of business travellers switching from traditional hotels to serviced apartments is likely to continue. Additionally, the undersupplied market in Europe, with high barriers to entry in the main metropolitan areas, will continue to help the industry drive both occupancy and average rate in the short- to medium-term. Lastly, branding will play an ever more important role in Europe, despite the limited exposure of branding currently on the continent. In short, an exciting future lies ahead for this sector.

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About HVS

HVS is the world's leading consulting and services organisation focused on the hotel, mixed-use, shared ownership, gaming, and leisure industries. Established in 1980, the company performs 4,500+ assignments a year for hotel and real estate owners, operators and developers worldwide. HVS principals are regarded as the leading experts in their respective regions of the globe. Through a network of more than 30 offices and 450 professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. www.hvs.com

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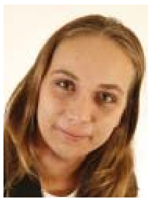

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