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IN FOCUS: THE HOSTEL AND BUDGET TRAVELLER MARKET IN EUROPE – GAINING MOMENTUM

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INTRODUCTION

The hostel market in Europe and elsewhere continues to evolve with the larger operators now competing with the limited-service hotel market. Furthermore, the cost of accommodation in major visitor locations is keeping the whole concept at the forefront of the property market, owing to the flexibility of design and ease with which small businesses can be set up with the right permissions, providing a viable investment alternative to offices or other income-producing asset classes.

Six years have now passed since the Lehman crash in September 2008, and affordability constraints are still being felt by both the leisure and corporate hotel guest segments. At the same time, development cost volatility and economic uncertainty have combined to polarise the hotel market; as the luxury and budget sectors have expanded, the squeezed full-service middle market segment has come under pressure to deliver a service commensurate with the rate premium it had grown accustomed to.

A largely risk averse investment market and a more socially aware corporate market has contributed to the rapid innovation of the limited-select-service hotel sector. This vibrant segment now presents the consumer more options and the investment market with more considerations. This year, HVS initiated a performance index to attempt to quantify the performance of the whole market so future investment decisions at every level can be made more informatively.

This update¹ has been compiled to coincide with the inaugural Hostel & Budget Traveller Conference 2014. In the following pages, we discuss the hostel and budget traveller market and draw conclusions that will be of interest to stakeholders and professionals within the sector.

¹ HVS previously published "The Sharing Market: Commercial Hostels" in Europe in July 2013.

Hostel & Budget Traveller 2014

Overview of the Hostel and Limited-Service Hotel Markets

The term 'ho[s]tel' has now gained acceptance in the market as defining the hybrid hotel product that combines hotel services with the informality and friendliness of a hostel. Owing to the owner-occupier nature of the wider hostel market, operational data remain largely confidential. Furthermore, information on the configuration of individual properties and the ratio of beds to rooms is not routinely available. In contrast, to further their expansion, the larger commercial operators such as Generator, Meininger and A&O are more comfortable with providing this breakdown to accelerate their market penetration. The simplicity of the whole concept, however, does not prevent performance comparisons being drawn immediately within the hotel sector and other asset classes on an amount per square metre basis.

The limited-service hotel market comprises established multinational operators and emerging independent brands. Again, the adaptability and cost effectiveness of this product is a key strength contributing to its rapid expansion, illustrated by new products such as Hub by Premier Inn and Tune Hotels, which have taken space in properties that one would previously have expected independent hostels to occupy. As a

result of this rapid global expansion, individual operators have had to become more innovative, stand out from the crowd and offset covenant strength differentials in order to secure opportunities in highly competitive situations.

This competition has also contributed to a more proactive approach to property re-investment, marketing and general hotel services, resulting in ‘amenity-creep’ in order to maintain existing guest levels and secure new business. In theory, owing to the nature of the fabric of the properties, these costs should be more affordable in relative terms for operators than those in the under-pressure full-service segment. These may also include the conscious promotion of the personalised ‘intangibles’ that make such a difference to someone’s stay.

The Development of the Ho[s]tel Model

Under the ‘ripple effect’, European economic conditions typically follow those in the USA, and the hotel market is no different – with the exception of ho[s]tels. Laws in New York City that were designed to prevent overcrowding and irresponsible landlord behaviour during the mass immigration of the late nineteenth century have remained with the support of the wider hotel market, making the introduction of the ‘multi-bed’ room concept difficult to achieve in the short term. That said, there are local nuances providing some flexibility and the expense of the city’s accommodation market makes it a long-term goal for many investors convinced of the latent demand that exists and lack of any fun alternatives.

FIGURE 1: A&O AND MEININGER LEAD THE MAJOR EUROPEAN HOSTEL OPERATORS BY NUMBER OF BEDS

Operator	Number of Hostels	Total Number of Beds	Owner	Selected Future/Target Markets
A&O	25	14,000	Mssrs Winter & Kluge	Amsterdam, Copenhagen, Zurich
Meininger	17	8,000	Cox & Kings	Paris, Barcelona, Rome, London
Generator	12	5,000	Patron Capital	Paris, Rome, New York
St Christopher’s Inns	18	2,200	Beds & Bars Group	London, New York
Wombats	7	2,000	Mssrs Dimitriewicz & Praschinger	London, Prague, Madrid
Equity Point	9	1,800	Equity Point Group	Paris, Florence, Venice
Plus Hostels	5	1,500	The Cardini Family	London, Paris, Amsterdam

Source: HVS Research 2014

The Sydell Group’s Roman & Williams-designed Freehand hostels are being considered in New York, Chicago and Los Angeles. The existing Miami property includes bars and swimming pools as well as shared rooms and facilities to provide ‘innovative design, a local eating and drinking experience, and a comfortable community atmosphere at an affordable price.’

Many similarities with this concept can be drawn with the Generator and Plus brands across Europe, both of which have made significant statements recently. Generator has secured an out-of-town resort site for its new Amsterdam property and Plus have won several awards for

its Berlin property, in part due to the amenities which include an indoor swimming pool and leisure facility, secure car-parking and attractive gardens.

PLUS BERLIN’S INDOOR SWIMMING POOL



This trend illustrates a movement into the conventional hotel market and will surely create an environment that attracts a wider guest audience who, in an age of ‘collaborative consumerism’, seek more than just dependable accommodation. This partly explains the slow reduction in the average number of beds per room across some groups, although the ‘quad’ still offers the greatest sleeper flexibility because it is large enough for four persons and small enough

FIGURE 2: FREEHAND MIAMI ROOMS CONFIGURATION

Room Type	Quantity	Number of Beds	Total Sleepers
Super 8	8	4	64
Shared Quad	10	2	80
Private Quad	10	2	80
Private King	14	1	28
Bungalow	1	2	8
Total	43	88	260

Source: HVS Research 2014

to be comfortable for 1. Figure 2 shows the Freehand Miami rooms configuration illustrating the property specific split. Elsewhere, those ho[s]tel operators that have emerged in response to schools-and-youth-groups demand as opposed to young travellers, may choose to arrange individual properties differently to ensure their core segment when present are suitably accommodated

In this competitive environment, the ability of the operator to maximise the efficiency of the converted and purpose-built properties that characterise the market and achieve a profitable balance from the different elements is now critical to the success of each operation. Cost inflation and room-rate pressure are forces affecting the top and bottom lines of profit and loss statements. Now that costs have often been cut as far as possible across the hotel markets, operators are concentrating on maximising economies of scale, direct bookings, length of stay and additional spend and rationalising non-profitable elements that may extend to withdrawing food and beverage facilities entirely.

The Limited-Service Hotel Market

As a more mature sector, the limited-service hotel market can no longer be simplified as a budget option for guests who prioritise price over experience. Organisations have managed to achieve greater value for guests in this sector through individuality and flair.

Figure 3 represents the brief conclusions of a focus group when asked the question, ‘In a perfect market what hotel room would you expect to achieve the highest price?’ The perfect market is defined as a space where brands have an equal presence with new hotel product, in an identical location and are subject to an informed, arms-length and equitable transaction. This pictorial representation – which professes to be neither exhaustive nor absolute - has highlighted some key issues, summarised as follows:

- The market is more crowded than ever before. Operators are having to evolve rapidly, requiring an adaptable approach to new opportunities at the same time as looking after their core business;
- A strong brand brings credibility and investor confidence. Brand recognition is paramount in order to continue to appeal to the diverse guest segments that make the model such an attractive investment class;
- Thousands of independent hostel operators are represented online by the established online travel agents (OTAs). We see an immediate opportunity for the franchise model in this space (similar to say, Best Western or Choice Hotels’ hotel model), to allow individual owners to benefit from the marketing and cost-based systems larger corporate organisations already enjoy;
- The sector is dynamic with lateral pressure. Commercial ho[s]tel operators have moved into the conventional hotel space targeting segments beyond their core school groups and

backpacker markets (for example, A&O and Meininger). Conversely, more established hotels are now looking to capture this specialist segment;

- Amenity-creep allows operators to move into the select-service market, where additional value can be sought from corporate guests required to make savings at a time when there is an acceptance that working performance should not be compromised by less expensive overnight conditions;
- The market also overlaps with the extended-stay hotel market that includes student accommodation and key-worker housing within the Private Rented Sector (PRS). Investors should be aware of the significance of branded operators such as The Student Hotel as it effectively transcends these divisions and offers opportunities for the further institutionalisation of this emerging asset class;

MAMA SHELTER MARSEILLE



- The larger multinational organisations are under constant pressure to maximise shareholder value. This has led to the expansion of the brands, such as Motel One’s move into the UK and Marriott’s introduction of the Moxy concept across Europe;
- Despite the power behind the multinational operators, there are opportunities and space in the market for smaller emerging organisations,

albeit these may be more opportunistic and rarer;

THE 500-BED HI-CHICAGO HOSTEL IN THE USA



- Everyone involved in the hotel sector should be aware of the potential impact of agents such as AirBnB, wimdu and onefinestay, which form the backdrop to the commercial spectrum. The bookings and tax transparency of this system facilitates easy quality control and financial monitoring. In theory this makes the exponential growth of options possible (admittedly where permitted) which offer the ‘service user’ a viable alternative in today’s ‘experience economy’.

Generally, good operators and concepts always gain recognition in the end. As the recent Tesco supermarket situation has illustrated, severe strategic challenges often follow market dominance resulting in competitor movement. Accor’s new ownership model and subsequent investment in Mama Shelter is a good illustration of a measure taken to mitigate any loss of business to concepts that are perhaps more in touch with millennials and the new guest segments, at the same time as buying into a concept that has been driven by a greater need by incumbent management to appeal to these sometimes uncaptured sources.

FIGURE 3: IN A PERFECT MARKET WHAT ROOM WOULD BE EXPECTED TO ACHIEVE THE HIGHEST PRICE?



Source: HVS Research

FIGURE 4: OPERATIONAL CHANGES ACROSS THE ‘PERFECT MARKET’



Figure 4 illustrates other important investment and operational characteristics as the market moves from the volume hostels on the left of the ‘perfect market’ across to the more strategic, select-service offers to the right.

Successful operators have had the ability to break out of this generalised profiling by managing guest expectations and delivering more than is anticipated, and therefore a fuller experience. This can manifest itself through quirky decoration in hotel bedrooms which make a property more interesting or bespoke; providing amenities and comforts typically only found in higher priced hotels; or generating a sense of family amongst staff that encourages proactive service and a reward structure that empowers employees to give a personalised service.

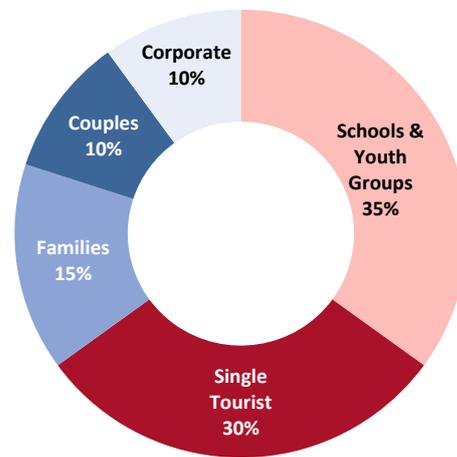
Operators which do these things well have full properties and are able to yield room revenue whilst optimising additional spending on food and beverage and meetings and events income.

Performance Benchmarking in the Hostel Sector

Whilst hotel occupancy is typically best measured by rooms, ho[s]tel occupancy is measured by beds. Similarly, room rate is replaced with bed rate and the occupancy and rate dynamic produces rooms revenue per available bed (RevPAB) instead of RevPAR. Bed occupancy sometimes mirrors local hotel market room occupancy but can be lower depending on the mix of multi-bedded rooms. Average bed rate is a function of the hostel’s direct sales to schools and

youth groups, individuals and other markets, as shown in Figure 5.

FIGURE 5: COMMERCIAL HO[S]TEL GUEST SEGMENTATION



Source: HVS Research 2014

In order to compare hostel performance with conventional hotels and other property classes, an analysis should focus on the metrics measured on a floor area basis (square metre or square feet). This allows the investor to more accurately compare rooms revenue and total revenue (that may include food and beverage spend and other income) across the whole market. Furthermore, routinely adopting this same approach to hotel lease payments and to the stabilised profit in a managed select-service hotel or similar asset, comparisons can be drawn with the wider property market that includes offices and private rented residential accommodation.

The hostel sector has also suffered from a lack of reliable benchmark data in general. HVS has recognised a requirement to initiate and

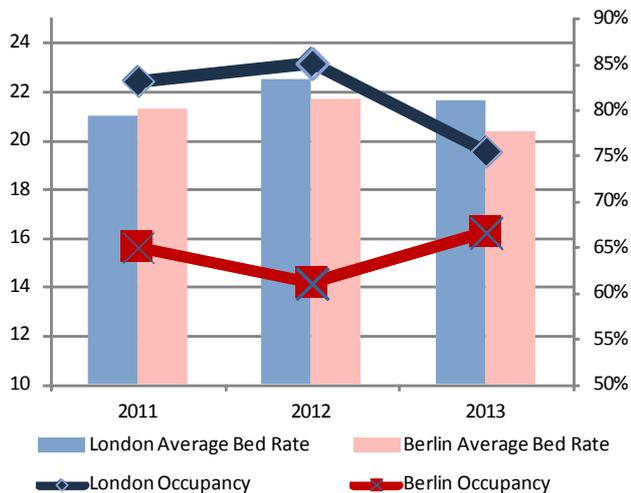
formalise our own data collection for this publication. A number of operators were invited to submit data that would allow an analysis of the aggregated key performance indicators. For the purpose of this publication, we focus on two of Europe's gateway cities – the European hotel capital, London, and the European hostel incubator, Berlin.

LONDON



A Tale of Two Cities

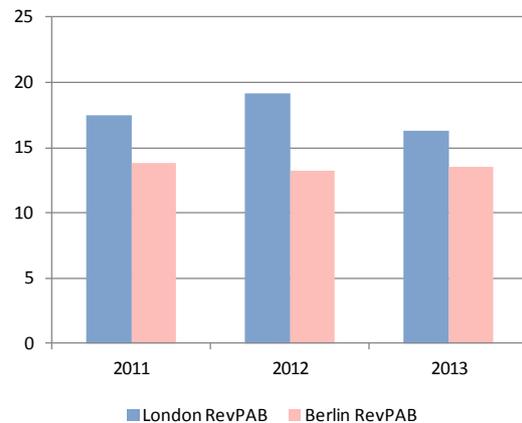
FIGURE 6: AVERAGE HO[S]TEL BED OCCUPANCY AND AVERAGE BED RATE – LONDON AND BERLIN (€)



Source: HVS Research 2014

Hostels in London achieve higher average bed rate and occupancy compared to Berlin. As a result of this dynamic, the RevPAB of London hostels is higher than that of those in Berlin, as illustrated in Figure 7.

FIGURE 7: REVPA B COMPARISON – LONDON AND BERLIN (€)



Source: HVS Research 2014

In the absence of revenue per square metre data, hostels and limited-service hotels can be compared on a RevPAR basis. Figures 8 and 9 illustrate how Ho[s]tels in London and Berlin perform compared to limited-service hotels in 2013.

BERLIN



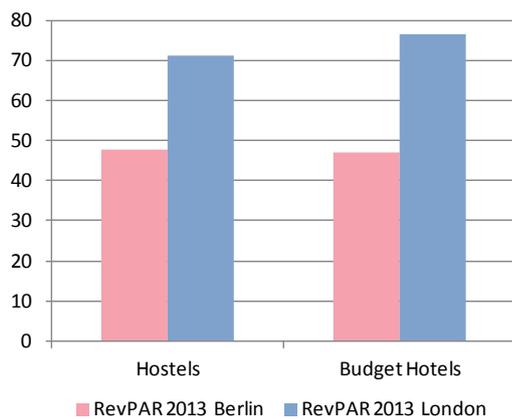
FIGURE 8: REVPA R COMPARISON – LONDON (£)



Source: HVS Research 2014

Whilst Ho[s]tels in London achieved a slightly lower RevPAR than the city’s budget hotels, in Berlin ho[s]tel RevPAR exceeded that of the hotels. With the optimal rooms and bed mix, a successfully operated hostel would expect to yield a similar or even higher RevPAR than a comparable limited service hotel.

FIGURE 9: REVPAR COMPARISON – BERLIN AND LONDON (€)



Source: HVS Research 2014

Outlook

The limited service hotel sector is an established, dynamic and liquid investment market (Louvre Hotels has been put on the market by Starwood Capital, Accor invested in additional hotels across

Europe and Goldman Sachs purchased the Grove Travelodge portfolio in a joint venture for £500 million), but the commercial ho[s]tels market remains a more opportunistic field.

Commercial ho[s]tels have aggressive expansion strategies for new markets in Europe and overseas; the whole sector is vibrant because of intense competition and remains a key investor focus. At this juncture, the simplicity of the whole concept should not prevent performance comparisons to be drawn immediately with the hotel sector, and other asset classes on a floor area basis.

As a result of the rapid international expansion, individual operators have had to become more

innovative and stand out from the crowd to offset covenant strength differentials and secure opportunities in highly competitive situations. These innovations include the conscious promotion of the personalised ‘intangibles’ that make such a difference to someone’s stay.

As operational costs are being cut, operators are concentrating on maximising economies of scale, direct bookings, length of stay and additional spend, and rationalising non-profitable elements. These measures may also be applied more macro-economically in the acquisition of further hotel lines to secure new business and accumulate brand loyalty.

MEININGER BRUSSELS CITY CENTRE





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About the Authors



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