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THE SHARING MARKET

COMMERCIAL HOSTELS IN EUROPE

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Introduction

The stated aim in Cox & Kings' recent takeover of Meininger was to create a leading hotel group in the combined hostel and hotel market. The commercial hybrid product is still a relatively new concept and investors should become more aware of this operational model as it expands into new markets.

Hostels: The Market Today

The flexibility and success of the European hostel market and the lack of any real benefit to the 'urban traveller' of hotels and motels beyond discounted prices, have convinced US billionaire investor Ronald Burkle to develop a group of hostel resorts to accommodate international visitors, and capture latent domestic demand. Through the Sydell Group's experience in lifestyle hotels, the Roman & Williams-designed hostels include 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.' Until now, the USA has trailed Europe in the development of commercial hostels, but this move has introduced the model to the wider investment community.

Formed in popular youth and student travel destinations and furthered by the economic downturn, the sector has experienced rapid growth in Africa, Asia, South America and across Europe. The ability of the operator to maximise the efficiency of the property and achieve a profitable balance from the different elements is now critical to the success of each operation.

The market in Europe typically consists of owner-operated backpacker businesses, strong regional companies often with operational links to university accommodation like Starboard Hotels' Smart City brand, national charitable organisations like the Youth Hostels Association (YHA), and large branded operators developed from existing scale businesses including Generator and St Christopher's Inns. Figure 1 schedules the major European hostel operators by number of beds. The type of hostel is generally defined by the characteristics of the available property within areas of high demand. As the product has become more widely known, the configuration of individual properties and the types of bedroom have evolved to accommodate guests' specific requirements and tastes in the urban environment or at resort locations.

Ho[s]tels

The term Ho[s]tel attempts to embody the hybrid product that combines hotel services with the informality and friendliness of a hostel. The hostel market is still relatively opaque, where information on the configuration of individual properties and the ratio of beds to rooms is not routinely available. This lack of transparency extends to the nature of the businesses themselves, which are predominantly owner-operated freehold interests with little need to disclose operating data. Despite this situation, growth-capital raising measures through share sales in companies such as Wombats and expansion by other groups have increased investor involvement and the quality of information available. This has highlighted a number of key similarities and differences with the wider hotel market.

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

Operator	Number of Hostels	Total Number of Beds *	Owners	Property Interests
A&O	22	14,000	Oliver Winter & Michael Kluge	Freehold and Leasehold
Meininger	17	7,000	Cox & Kings	Leasehold
Generator	11	5,000	Patron Capital	Freehold
St Christopher's Inns	17	2,000	Beds & Bars Group	Freehold and Leasehold
Wombats	6	1,900	Sascha Dimitriewicz & Marcus Praschinger	Freehold and Leasehold
Equity Point	9	1,800	Equity Point Group	Freehold and Leasehold
Plus Hostels	3	1,100	The Cardini Family	Freehold and Leasehold
Hip Hop Hostels, Paris ¹	12	1,000	Thomas O Huertas	Freehold and Leasehold
Euro Hostels, UK ¹	3	900	Andrew Silverstone	Leasehold

* Approximate

¹ Selected others

Source: HVS Research 2013

Whilst hotel occupancy is measured by rooms, hostel performance is measured by beds, with the occupancy and average rate dynamic producing Revenue per Available Bed (RevPAB). Occupancy largely mirrors and often exceeds local hotel market occupancy, and average rate is a function of the hostel’s direct sales to groups and individuals and the increasingly critical online travel agents (OTAs). A selection of prominent hostel OTAs are pictured below.



There are already several effective hostel OTAs, however hostel operating systems are not yet sophisticated enough to account for flexible bed numbers available on a per-night basis. So despite fluctuations, the number of beds in each unit currently remains fixed during an accounting period, although this will eventually change.

The ratio of beds to rooms is dependent upon the guest segmentation of the business the individual hostel accommodates, the property it operates from and local planning restrictions. Operators typically configure new units to maximise bed occupancy and exceed customer expectations by providing the appropriate number and type of rooms suitable for the target groups. In the UK for example, commercial hostels fall into the C1 (Hotels) Use Class and not the Sui Generis Hostel classification relating to temporary accommodation for the homeless and vulnerable.

FIGURE 2: THE QUAD IS SEEN AS THE OPTIMAL ROOM TYPE – FREEHAND MIAMI CONFIGURATION

Room Type	Quantity	Number of Bunk 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: Freehand Miami 2013

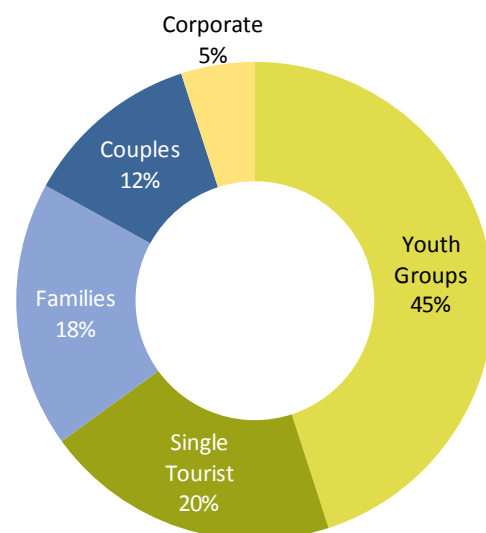
Local planning and safety restrictions, however, may prevent the development of commercial hostels, forcing operators to configure a property

more like a hotel; approximately 50% of Generator’s new hostel in Berlin Mitte will comprise double rooms with en suite shower rooms. Already a viable alternative to Travelodge and Premier Inn, because of their improved rooms-product and as a consequence of local planning laws, UK hostels are now competing head on with limited-service lifestyle hotels such as the Motel One, Tune and CitizenM brands. Figure 2 illustrates the broad configuration of the Freehand Miami, a conversion of a 1930s Art Deco hotel.

Guest Profile

Figure 3 illustrates the segmentation profile of typical commercially operated hostel with educational groups underpinning its occupancy. An increase in the minimum standards accepted by youth groups has meant that hostels have attracted new markets, becoming a more cost-effective form of overnight accommodation for families and corporate travellers. In most locations, the ideal room-type is perceived to be a quad (that is, variations of twin beds and a bunk bed), because its flexibility enables a hostel to react to both seasonality and the requirements of the individual traveller. Whilst shared rooms and

FIGURE 3: YOUTH GROUPS ARE KEY, BUT FAMILIES AND CORPORATE GUESTS ARE ON THE RISE



Source: HVS Research 2012

bathroom facilities still exist, female-only rooms and floors are often provided, and a greater proportion of hostel rooms now have en-suite

bathroom facilities and amenities, such as flat screen TVs and private lockers as standard; many have small kitchens for the use of residents, which especially suit students and couples with young children travelling on a budget. A typical modern quad is 18 m² and around 10 m² is required per bed on an overall basis, including within the larger dorms.

The Bottom Line

With operators focussing predominantly on bed sales, food & beverage (F&B) revenue in hostels varies considerably; consistent with conventional bed & breakfast operations, F&B typically accounts for no more than 15% of total revenue. Profitability may be up to 65% on account of the limited menus and all-day snack offers that may also include high-margin alcohol sales served from the reception desk, where permitted. In addition to more efficient utilities distribution and lower energy consumption than hotels, further cost efficiencies can be made where economies of scale exist to reduce wage costs attributable to servicing the rooms, as fewer staff are required to run the business than in a conventional hotel.

The bottom line pre-tax net operating income before rent and/or financing costs generated by commercial hostels can range from 25% to 30% of total revenue and is largely dependent on the configuration and scale of the property, and the target market. Rents across Europe have therefore been negotiated and set at sustainable levels to reflect these operational characteristics. There remains a degree of uncertainty amongst the investment community about the role of hostels in commercial property, however, Meininger's AA Treugast investment ranking demonstrates the financial strength achievable by a potential tenant.

The Future

Anxious to avoid underage drinking and other anti-social behaviour that was prevalent in some small businesses in the past, the larger commercial operators take great care in creating a clean and safe environment that engages guests and appeals to every demographic. To remain competitive, hostels need to keep up with modern trends and so by their nature require dynamic hands-on management often preferring to market themselves as a group of individual venues rather than a chain of hotels. With good growth prospects for the school accommodation market and other forms of group-travel still to be captured, as the only form of the serviced dormitory experience in a cost conscious world, hostels are in a strong position.

As this sub-sector of the wider hotel market matures, there will be a higher proportion of leasehold models as groups look to penetrate new markets more rapidly. Further consolidation will also generate transactional information and an increasing focus on yield management that identifies the value of the individual business segments. No formal performance benchmarking service for the hostel sector currently exists which will challenge banks and other investors to become better informed about its performance and prospects, especially when identifying the risks attached to individual management agreements. From our analysis of a number of European destinations, it is clear that this market is set to enjoy rapid growth and continued interest from major companies keen to diversify their operational exposure.

Clearly there are many similarities with the wider hotel market. Investors and developers can look forward to a burgeoning database of operating statements when identifying a) the value of hostels and b) the return on investment achievable from the conversion of existing buildings and development of purpose-built properties.





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About the Author



Harry Douglass is a Senior Associate with HVS's London office, specialising in hotel valuation and consultancy. He holds a MSc in Real Estate Management and qualified as a member of the Royal Institution of Chartered Surveyors (MRICS) in 2006. Harry joined HVS in 2012 following six years within the UK licensed and leisure property sector. Recent assignments at HVS have included hostel and hotel feasibility studies; loan security valuations; desk-top market assessments and transaction negotiation and due diligence.

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