

PRINCIPAL REAL ESTATE

European Hotel Sector: Value Opportunities in Lifestyle Luxury

AUTHORS



Graeme McCormack
Head of Hotel Fund
Management



Hugo Steen
Head of Hotel
Investments

Historically, value investors tended to avoid the luxury hotel market, which primarily attracted investors seeking trophy assets. Since the pandemic, however, [changing demand](#) has opened up new value creation opportunities.

The number of high net-worth individuals around the world has grown significantly, and post-pandemic, they're eager to travel. But the way they travel is different now. Consistent with the broader trend in travel and leisure, high net worth individuals have demonstrated a preference for authentic experiences. This has opened a new segment in the luxury hotel market: lifestyle luxury.

In contrast to traditional 5-star hotels ('classic luxury'), lifestyle luxury is about the experience—a unique property in an interesting location, highly desirable bars and restaurants, a place visitors and locals alike want to see and be seen. A lifestyle luxury property is more likely to have a Michelin-starred restaurant than a spa and an intriguing backstory than a famous name.

In this paper we explore the factors driving demand in this new segment and the high performance we're seeing as a result. We'll share how investors can capitalise on the significant value opportunities in the luxury lifestyle hotel market (including by finding unique properties and crafting the kinds of experiences high net-worth individuals are keen to pay for) and examples of such value creation.

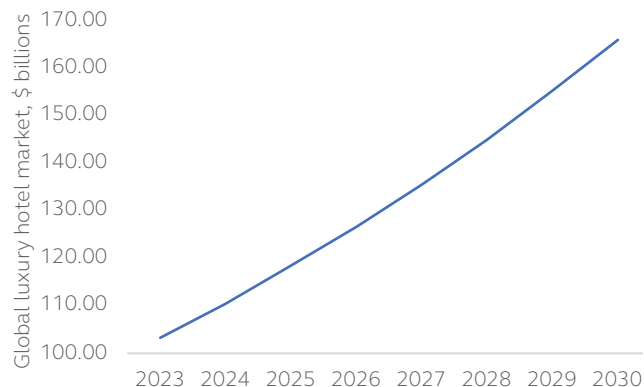


Luxury travel demand is strong

The luxury travel market rebounded well after the pandemic. The number of bookings of five-star hotels grew by 19 percent in the first three quarters of 2022 compared to the same period in 2021.¹ The global luxury hotel market size was valued at \$103.39 Billion in 2023 and is projected to reach \$166.04 Billion by 2030, growing at a compound annual growth rate (CAGR) of 6.1 percent from 2024 to 2030.²

The rebound reflects pent-up demand for travel among consumers with significant disposable income; when China released its pandemic lockdown measures, for example, travel out of the country surged. But it's not only the post-pandemic surge that is driving demand for luxury travel: the rising number of high net-worth individuals has and will continue to create and sustain new demand.

EXHIBIT 1: Global luxury travel is on the rise

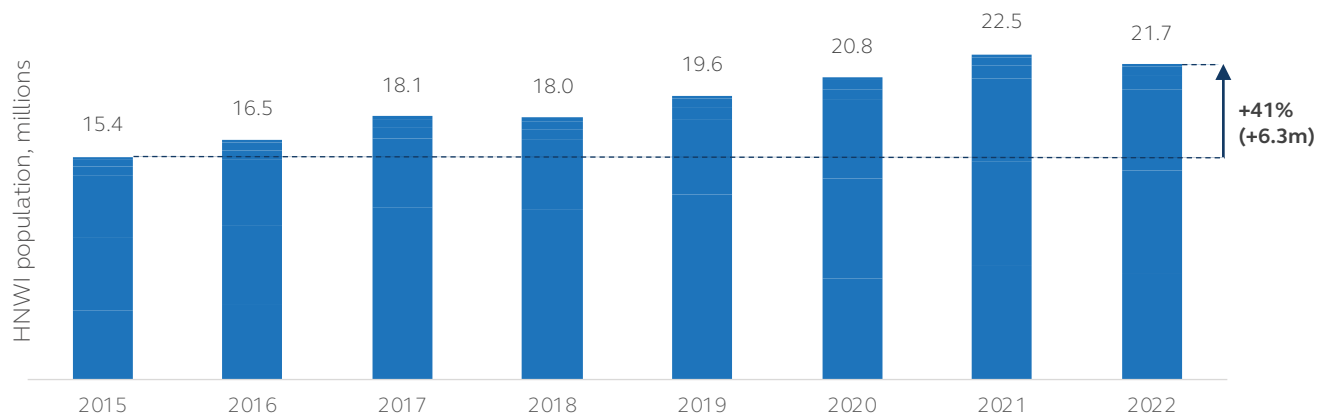


Source: Grand View Research, Luxury Travel Market Size, Share And Growth Report, 2030. January 2024.

Rising number of high net-worth individuals

High net-worth individuals (HNWIs, those with a total net-worth of at least \$1.0 million) make up a small share of the world's population (0.3 percent). But the population of HNWIs is rising, driven in large part by emerging economies where rapid industrialisation and technological advancements are propelling economic growth.

EXHIBIT 2: The population of high net-worth individuals is rising rapidly



Source: Capgemini Research institute for financial services analysis, 2023.

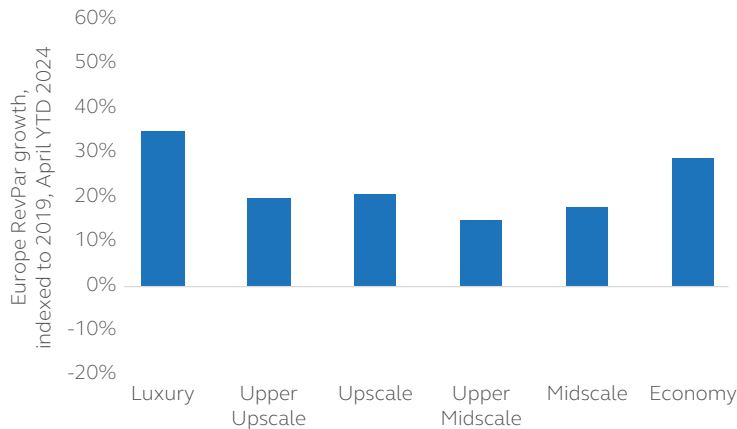
Despite the fact that high net-worth individuals make up less than one percent of the global population, they account for a relatively outsize share of global travel spending (36 percent) and luxury travel spending (nearly 70 percent) worldwide.³ As the population of HNWIs grows, aggregate spending on luxury travel grows as well.

¹ Deloitte, A World In Motion: Shifting consumer travel trends in 2022 and beyond, January 2023.

² Grand View Research, Luxury Travel Market Size, Share And Growth Report, 2030. January 2024.

³ JLL, Growth in worldwide wealth vaults global luxury travel to new heights creating increased investor interest, 15 May 2023.

EXHIBIT 3: Spending on luxury travel continues to grow in Europe



Source: STR, CoStar, European Hotel Performance Update, April 30, 2024.

Shifting preference toward experiences drives a new type of luxury hotel: Lifestyle luxury

Global consumers spent more of their income on travel in 2022 than any other category, aside from food and technology.³ The increased emphasis on travel was particularly notable among affluent individuals; 44 percent placed a higher emphasis on travel since the pandemic, according to a YouGov survey.³

Travellers “are increasingly prioritising experience and hotels that offer consistently reliable service alongside local authenticity.”⁴ These shifting preferences have opened a new segment of the luxury hotel market: lifestyle luxury.

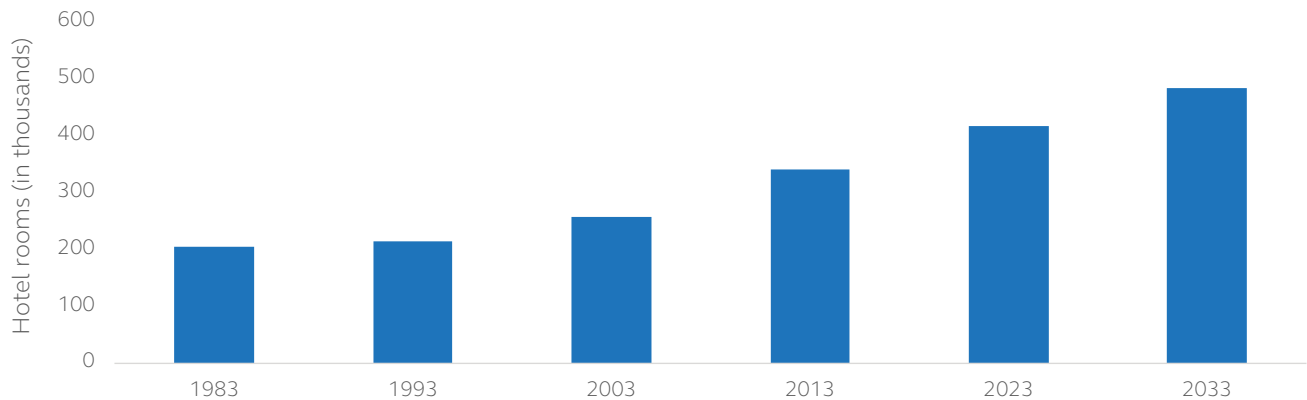
In contrast with traditional 5-star hotels (‘classic luxury’) that offer brand caché and traditional amenities like spas and golf, lifestyle luxury products are typically unique properties in interesting locations offering authentic experiences.

High net-worth individuals increasingly prefer these luxury lifestyle products. “Modern travellers are no longer content with cookie-cutter amenities and services; they are seeking bespoke experiences that cater to their specific needs and tastes... Luxury hotels are adept at offering such customised experiences, from personalised dining menus to curated local tours.”⁵

Supply of luxury hotels is growing, but not as fast as demand

Luxury hotels comprise an increasingly large share of global hotel supply, although the supply of luxury hotel products is not rising as rapidly as demand. By 2033, there will be 1.7 million luxury hotel rooms in the world, equating to 7.6 percent of total hotel supply.³

EXHIBIT 4: The supply of luxury hotels in Europe, Middle East, and Africa (EMEA) is rising



Source: JLL Research, STR Census as of Feb 2023.

Notes: Luxury supply uses STR classifications and is measured in number of rooms, 2033 supply based on rooms currently in planning, final planning and construction phases only.

⁴ Principal Asset Management, European Hotel Sector: Creating value through demand-driven transformation.

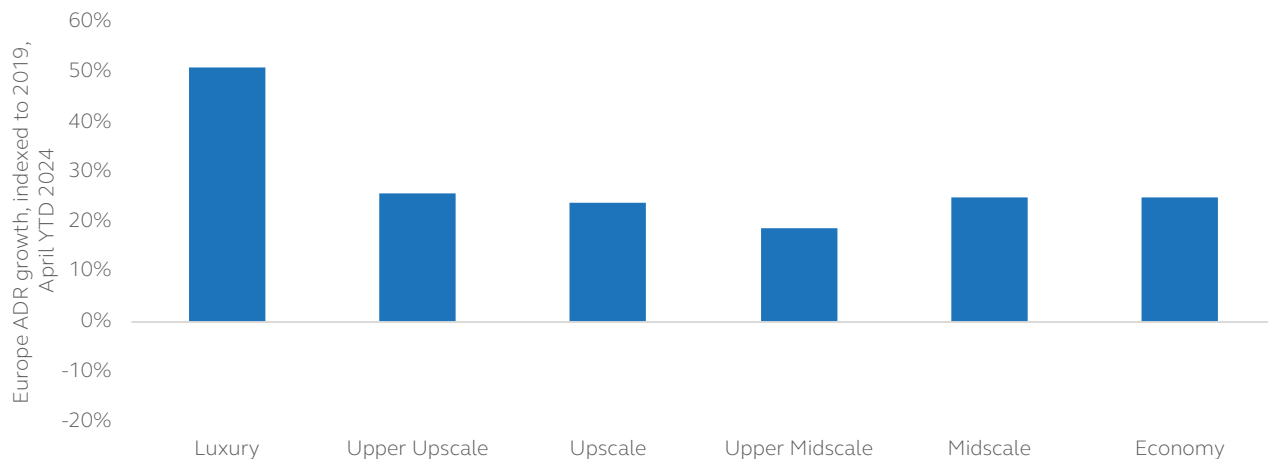
⁵ International Market Analysis Research and Consulting Group, Luxury Hotel Market Report, 2023.



With demand outstripping supply, luxury hotel performance is strong

With demand for luxury hotels outstripping supply, average daily rates (ADRs) have risen to new heights, well above pre-pandemic levels. In Europe, luxury ADR reached \$469 in 2022, its highest point ever and 135 percent of the pre-pandemic ADR.⁶ With nearly all pandemic-era travel restrictions lifted, growing numbers of high net-worth individuals, and rising demand for luxury hotels, we expect luxury hotel rates to remain elevated even if the rate of their increase moderates.

EXHIBIT 5: Luxury ADRs have risen to new heights



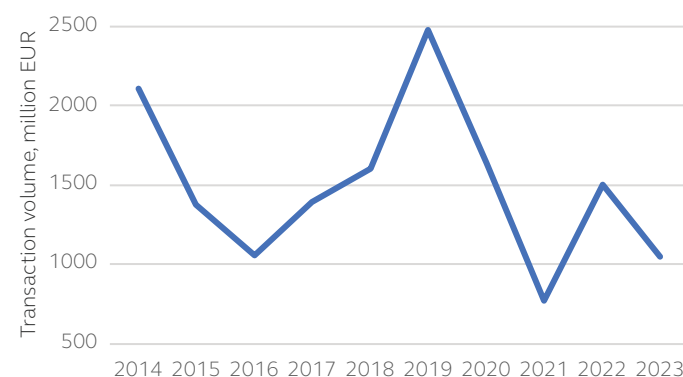
Source: STR. April 2024

⁶ JLL, The evolution of global luxury hospitality, 15 May 2023.

There are significant value opportunities for investors with lifestyle luxury

Given the rising number of high net worth individuals and their preferences for lifestyle luxury hotels, it is no surprise that investors are recognising the new value creation opportunities in this market. Global sales of luxury hotels grew 39 percent in 2022, with even stronger growth in Western Europe (45 percent), according to Euromonitor. In comparison, budget hotel sales globally grew 23 percent.⁷

Exhibit 6: Europe luxury hotel transaction volume



Source: RCA. March 31, 2024.

How to capitalise on the lifestyle luxury opportunity

The dynamics for investors in the luxury hotel market have changed, primarily in the lifestyle luxury segment. Ultra-luxury hotels are still difficult for value investors because margins are so thin. Classic 5-star properties, likewise, continue to remain the purview of long-term investors seeking trophy assets. However, lifestyle luxury hotels do present significant opportunities for value investors. Capitalising on the opportunity depends on matching service delivered to guests' expectations, offering unique experiences, and seeking markets with gaps between demand and supply.

Focus on service

For all types of luxury hotels, service is key, though the kind of services guests are looking for in each category is subtly different. In all cases the product has to deliver on expectations, and in the case of lifestyle luxury hotels, the expectation centres around personalised, authentic local experiences.

A good example of a value creation investment strategy centred on service is a former Belgian monastery and hospital dating back to 1238. In the 16th century, pharmacist Peeter van Coudenberghe developed a medicinal garden where he grew herbs for his remedies. When the property was acquired several years ago, the vision was to renovate it into a wellness, dining, and hotel destination centred around the centuries old botanic story. Today, the hotel is home to Michelin-starred restaurants and a spa that incorporate botanicals from the garden.⁸

Find a great property and create an experience

As is the case with any value creation strategy, the first step to success is finding a property that's undervalued—in this case, an interesting building that is well-located with the kind of backstory that drives demand from those seeking

authentic local experiences. Perhaps it's a four-star hotel. It may not be a hotel at all. But by renovating it and crafting an experience around it, you bring it into the luxury market and can generate outside returns relative to the investment.

A set of palaces built in 1887 by famed Italian architect Gaetano Koch provide a good example of this value creation strategy. The property was originally comprised of two porticoed, semi-circular, private palaces ringing one side of the Piazza della Repubblica in Rome. Acquisition and transformation of the property retained the "sense of history and place you cannot build from scratch today."⁹ The strategy was similar with the five-star hotel in London where renovations of the 1851 property included establishment of a new restaurant spearheaded by Michelin-star chef and personal gin bars in each guest room.¹⁰

Look to markets with supply gaps

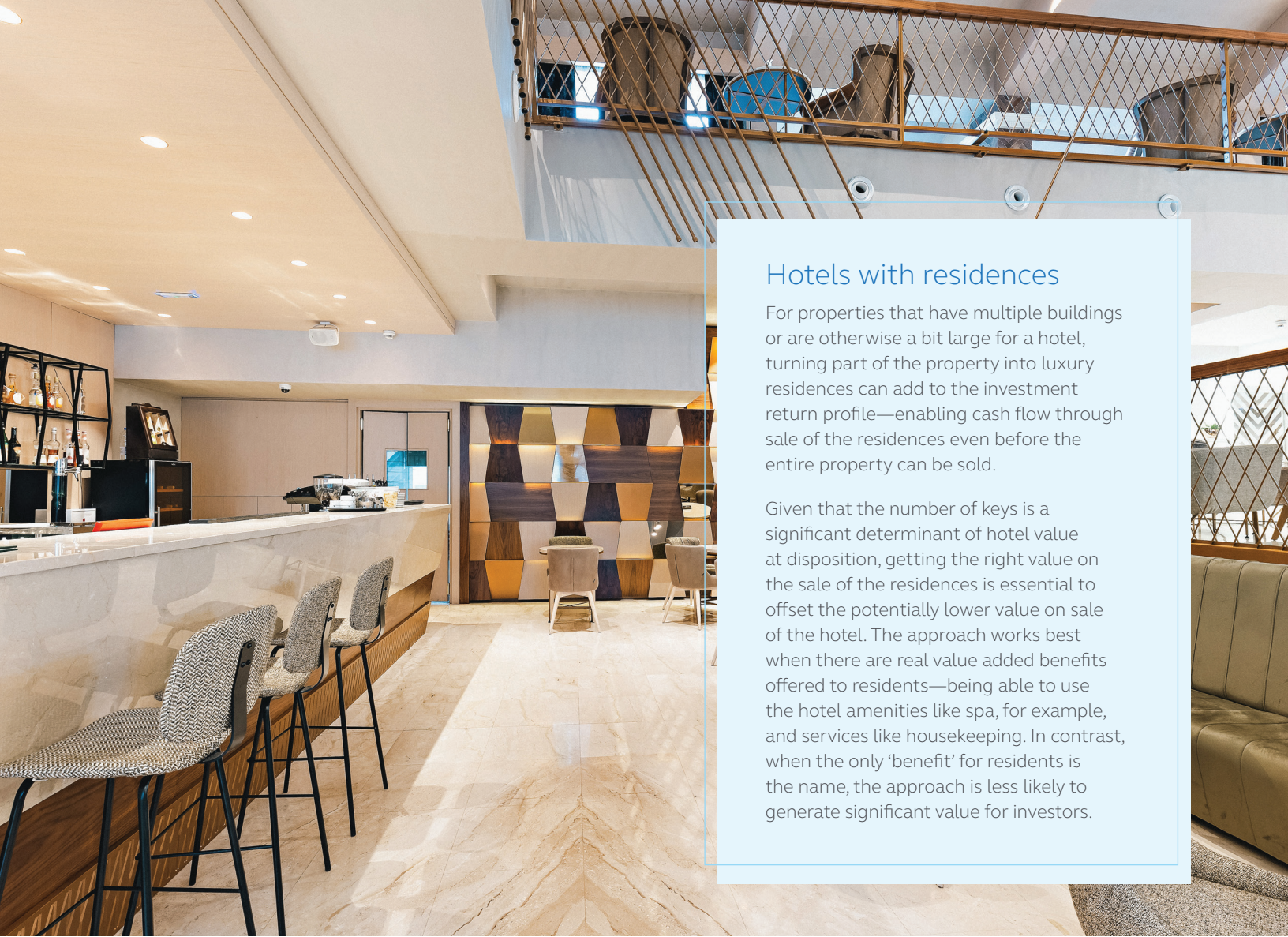
Certain European markets have more opportunities like the ones described here. There are markets with larger gaps between demand and supply. However, value creation isn't about market making; wise investments are in cities with the attributes that lifestyle luxury travellers seek—including dining, shopping, and cultural experiences. Even in markets with a large supply of luxury hotels (Paris, London) there are opportunities to create value.

⁷ Deloitte, A World In Motion: Shifting consumer travel trends in 2022 and beyond, January 2023.

⁸ Tatler, 5 European hotels, from Splendido in Italy to Mandarin Oriental Palace Luzern in Switzerland, that blend classic charm with modern revival, 4 February 2024.

⁹ Forbes, Better Than Ever Renovations—Most Improved Luxury Hotels For 2024, 8 January 2024.

¹⁰ USA Today, Five recently revamped European luxury hotels, 24 August 2016.



Hotels with residences

For properties that have multiple buildings or are otherwise a bit large for a hotel, turning part of the property into luxury residences can add to the investment return profile—enabling cash flow through sale of the residences even before the entire property can be sold.

Given that the number of keys is a significant determinant of hotel value at disposition, getting the right value on the sale of the residences is essential to offset the potentially lower value on sale of the hotel. The approach works best when there are real value added benefits offered to residents—being able to use the hotel amenities like spa, for example, and services like housekeeping. In contrast, when the only ‘benefit’ for residents is the name, the approach is less likely to generate significant value for investors.

Conclusion

A successful value creation investment strategy starts with understanding how demand has changed and how to transform the property to better meet that demand. The increasing number of high net-worth individuals demanding personalised and authentic local experiences creates opportunity for strategic value creation in the lifestyle luxury market. As is always the case, having a partner with local market expertise and experience with demand-driven transformation is essential.

To learn more, please visit

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