

PRINCIPAL REAL ESTATE

European hotel sector: Sustainability is a competitive necessity

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Once a competitive advantage, sustainability is now imperative in the European hotel sector. Investors and operators both have responsibilities to be good stewards of the environment and of the communities in which they operate. In many ways, financial performance depends on sustainability. A strong sustainability strategy enables stakeholders to identify opportunities and manage risks related to environmental, social, and governance (ESG) factors—as well as drive performance to create long-term value.

The shift from sustainability as competitive advantage to sustainability as competitive necessity is driven by several factors:

- Awareness of climate change and its human impacts is now ubiquitous, and many people have experienced those impacts firsthand. As a result, travellers are more likely to be eco-conscious, making hotel selections with sustainability considerations in mind, and employees are more likely to want to work at hotels that prioritise their health and well-being.
- Inflation put significant added pressure on operators to reduce costs and increase efficiency.
- Increasingly stringent environmental regulations, often on capital lenders, mean fewer potential buyers and forced price discounts for non-compliant properties, which strengthen the financial case for sustainability as a competitive necessity.

Together, these factors have made sustainability a competitive necessity in the European hotel sector. In this paper, we explore why sustainability matters for hotel investors and how to think about sustainability in property selection, capital improvement, operating structure, and operations.

Why sustainability matters

Sustainable practices yield environmental and financial benefits. For example, reducing resource consumption (e.g., energy and water), carbon emissions, and waste minimises the impact of operations on the environment. At the same time, improved energy and water efficiency and reduced waste also reduce operational costs.

Travellers are more likely to stay at hotels that prioritise health and well-being. Brands are already demonstrating the reputational benefits of sustainable practices, including positive community impact—which in turn boost attraction and retention

of guests and employees alike. Operators can demonstrate sustainability commitments through promoting transparency and seeking certifications such as LEED and BREEAM.

Sustainability also improves resiliency for hotel operators and investors. A robust ESG strategy helps identify and manage climate-related risk. It is also an opportunity to ensure compliance with ever-stricter regulations. Improving resiliency in these ways mitigates the risk of asset stranding and potentially increases asset value at disposition.

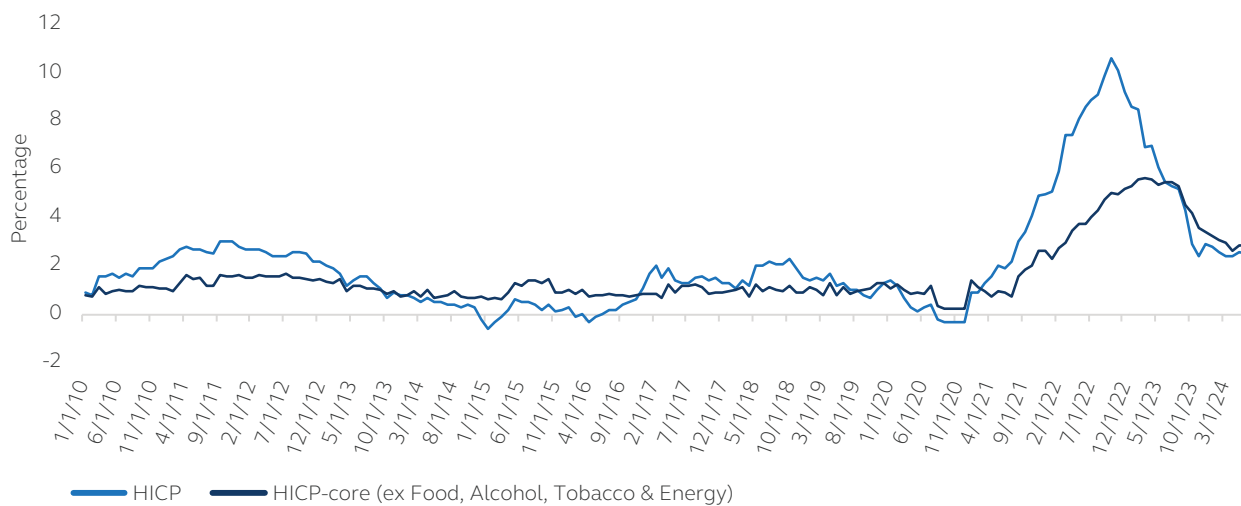
Sustainability is an opportunity to increase hotel performance

Hotel sustainability practises reduce costs by improving resource efficiency and minimising waste, and potentially increasing revenue by attracting the growing number of eco-conscious travellers.

Improved resource efficiency and minimised waste reduces operating costs

Inflation began to rise in 2021, spiking to a level more than double the decade's previous peak. It has begun to moderate, but several years of record-level inflation put significant pressure on hotel operators to cut costs. Resource efficiency and waste reduction measures—even ones that had not been economically viable previously—began to make economic sense.

EXHIBIT 1: Post-pandemic inflation puts significant pressure on operating costs



HICP (Harmonized Index of Consumer Prices)
Source: Eurostat. As of 1 August 2024.

Hotels that prioritise sustainability may reduce operating costs by up to 30%, according to research by the Sustainable Hospitality Alliance.¹

Common resource efficiency and waste reduction measures that reduce operating expenses include:

- ✔ Energy-efficient fixtures, such as LED lighting and A-rated appliances—which lower energy costs
- ✔ Automated energy management systems that, for example, turn off the lights and raise the room temperature when the guest is away—which also lower energy costs
- ✔ Water-efficient fixtures and systems, such as low-flow toilets and rainwater harvesting—which reduce water costs
- ✔ Food waste minimisation programs such as elimination of buffets and reliance on seasonal products and local distribution channels—which reduce food costs
- ✔ Refillable dispensers for bathroom amenities and reusable products such as water bottles—which decrease waste and disposal expenses

The cost savings associated with resource efficiency and waste reduction measures can be significant. For example, switching to LED lighting can offer an ROI of 20-30% annually, according to the tourism trade association Skal Europe. ROI for high-efficiency HVAC systems can be 10-20% annually, with energy savings of up to 30%.²

¹ World Sustainable Hospitality Alliance, Building Green and Resilient Hotels: Investing in our Planet, 21 April 2023.

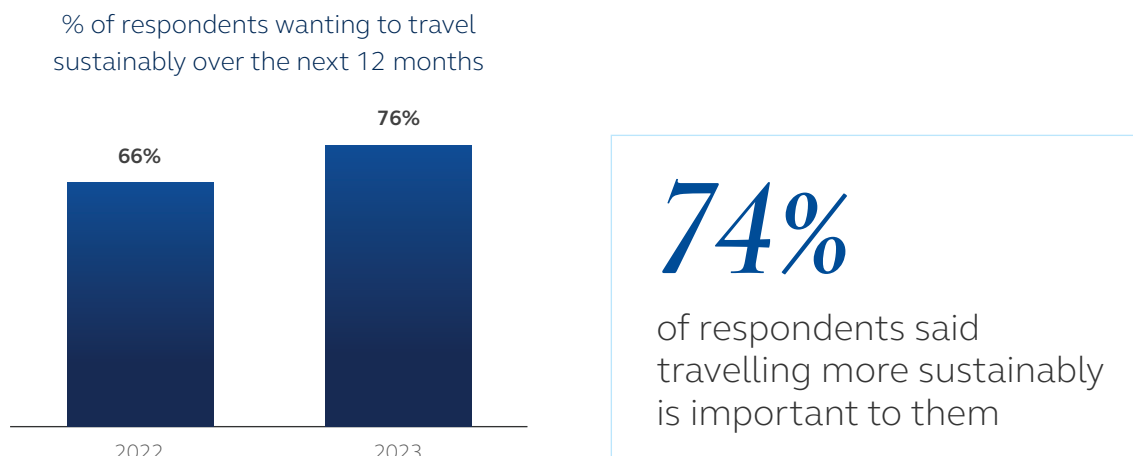
² Skal Europe, Transforming Tourism: Energy Efficiency for Big Savings and Sales, 22 May 2024.



Attracting the growing number of eco-conscious travellers may increase revenue

People are increasingly incorporating sustainability practises into their daily lives—turning to energy efficient appliances, reducing water waste, and eliminating single-use plastics, for example. This heightened awareness extends to the environmental impact of travel, and more travellers seek hotels that practise sustainability.

EXHIBIT 2: Travellers increasingly care about minimising their environmental impact



Source: Booking.com Sustainable Travel Report 2023

The rewards for hotels that meet eco-conscious travellers' demand can include higher average daily rates and higher guest satisfaction. For example, a Mabrian survey of 14,000 hotels in Spain found that hotels with sustainability practises realised a 5% price boost and a 15% guest satisfaction boost.⁴

Beyond travellers' concern about environmental impact, there is an increasing focus on health and well-being among both guests and employees. In a 2024 global survey by Deloitte, more than eight out of 10 executives said a stronger commitment to prioritising a positive human impact would increase their company's ability to attract new talent (82%), appeal to customers and clients (81%), and profitability (81%).⁵ By investing in health and well-being practices, hotels can increase attraction and retention of guests and employees.

Sustainability is an opportunity to increase value at disposition

In addition to potentially enhancing performance by reducing costs and increasing revenue, a hotel's sustainability practise may help to increase the property's marketability and value at disposition. Even just five years ago, modest energy efficiency improvements and water-saving practises gave a property a competitive advantage at asset disposition. Now, properties without significant sustainability practises may face a disadvantage at disposition, and may have to sell at a discount.

This change is driven in large part by increasingly stringent environmental regulations. The EU Energy Efficiency Directive requires member states to meet energy efficiency targets by 2030.³ The Energy Performance of Buildings Directive (EPBD) requires hotels to monitor and reduce their energy use, and the Waste Framework Directive (WFD) requires hotels to reduce waste and encourage recycling. Many sustainability regulations target banks—affecting the types of properties banks underwrite and, in that way, driving sustainability improvements by property owners.

Potential buyers understand that sustainability expectations—from travellers, regulators, and lenders—will be increasingly stringent. The properties that appeal to the broadest range of buyers and are least likely to face price discounts, then, may be best positioned to meet rigorous expectations well into the future.

³ European Commission, Energy efficiency targets

⁴ Mabrian, Sustainable hotels earn 5% more, 21 November 2023.

⁵ Deloitte, The important role of leaders in advancing human sustainability, 18 June 2024.

How to be sustainable

Not all sustainability practices equally have the potential to increase hotel performance and value at disposition. For investors in the European hotel sector, decisions around property selection, capital improvement, operating structure, and operations affect the extent to which performance and value are optimised.

Sustainability in property selection

There is a wide range of factors for investors to consider when deciding on a property to acquire. One is the cost and time required to bring the property up to the level of sustainability that may increase hotel performance and value at disposition. When the building was built and how it has been improved over the years are factors that matter, but current sustainability and improvement needs are best determined via a rigorous assessment.

Investors must also consider the prevailing regulatory environment where the property is located. Some governments offer incentives such as tax benefits, grants, or subsidies for capital projects that improve sustainability. But regulations can also limit the kinds of capital improvements that can be made, in particular for historic buildings.

➔ **Learn more** about property selection considerations beyond sustainability in our paper [Identifying opportunities for value creation.](#)

Sustainability in capital improvement

The largest efficiency gains often come from the largest capital improvement expenditures—insulation upgrades, for example, can reduce energy consumption by up to 40%, according to Skal Europe.⁶ As energy costs continue to rise, investments that generate positive returns and increase efficiency may become easier to justify. Key to decision making in this case is assessing the return on investment the capital improvement could generate.

➔ **Learn more** about operating structure considerations beyond sustainability in our paper [Creating value through demand-driven transformation.](#)

Sustainability in operating structure

Many of the most effective sustainability practises for potentially increasing performance and value are operational—and therefore depend on the hotel operator. Furthermore, in many cases, investors' sustainability reporting must take tenant activities into account. Owners have more or less control over tenant activities depending on the operating structure in place; lease agreements typically give the owner very little control while management contracts and franchises allow owners a much greater degree of involvement. Therefore, the operating structure is an important sustainability decision for investors to make.

➔ **Learn more** about operating structure considerations beyond sustainability in our paper [Choosing the optimal operating structure and partner.](#)

⁶Skal Europe, Transforming Tourism: Energy Efficiency for Big Savings and Sales, 22 May 2024

Sustainability in operations

When considering an operator, strategic alignment is essential, as a tenant not truly committed to sustainable operations can negatively affect performance and value. For operators, sustainability includes implementing resource efficiency and waste reduction measures that reduce operating expenses. Given rising costs and increasingly stringent regulations, operators can now justify larger investments to improve efficiency and reduce waste.

Moreover, operators should want to be seen by guests as good environmental stewards, be recognised as good employers by corporate standards, and fundamentally want to improve performance. Savvy operators recognise that sustainability, effective staff management, and performance are inextricable. Happy employees who feel they are making a positive impact on the environment will positively impact guest experience—which then drives performance.

Given the increasing focus on health and well-being among both guests and employees, many operators are now investing in that area. Eliminating volatile organic compound (VOC) products and finishes and implementing green cleaning practices, for example, makes for a healthier environment in which to work and stay. Hotels are increasingly offering wellness amenities—in small ways such as essential oils for sleep, and large ways such as new fitness programs and nutritional offerings. Many of the practices that attract travellers looking for authentic local experiences—locally sourced food, for example—also add value to the community.

For many operators, sustainability is now integral to brand identity. This shift is reflected in marketing communications designed to attract eco-conscious travellers as well as in on-property communications. Many hotels now prominently display signs showcasing sustainability efforts and invite guests to contribute, for example, by opting out of daily laundering of bath and bed linens. By fostering a sense of involvement and showing how guests are making a difference, these efforts contribute to the overall guest experience.

For example, one relatively new hotel chain is staking its claim on sustainability—supporting causes through charitable partnerships globally, embracing locally sourced food and other products, eliminating single-use plastics, and reducing waste. Additionally, the brand enhances its appeal with properties in unique locations, offering authentic local dining, wellness, and other experiences, and featuring spaces designed to foster community. We expect to see more brands follow suit with similar models.

Sustainability in practise: How Principal Asset Management strives to increase performance and value

To meet the requirements of eco-conscious hotel guests and deliver positive financial and sustainable outcomes, as an asset manager Principal Asset Management is committed to mitigating assets' environmental footprint, enhancing climate resilience, focusing on health and wellbeing, engaging key stakeholders and partners on sustainable performance, and designing and operating sustainable buildings.

HEALTH & WELLBEING

- Green cleaning
- Wellness amenities
- Low/no VOC products and finishes

ENVIRONMENTAL FOOTPRINT

- Sustainably managing energy and water use
- Increasing waste diversion
- Reducing carbon emissions
- Optimising the use of renewable energy where feasible

SUSTAINABLE DESIGN

- Resource and material management
- Building certifications
- Technology and smart building innovation

DATA TRANSPARENCY

- Benchmarking utility data
- Framework alignment
- Shareholder reporting

A photograph of a hotel room. In the foreground, two beds are visible, each with a white pillow and a decorative, patterned bed runner. The beds are positioned against a large, tufted, light-colored headboard. Above the headboard, there is a decorative, multi-tiered lamp with a warm glow. The room has a classic, elegant feel with a patterned carpet and a white ceiling with recessed lighting.

Conclusion

As we have discussed throughout this European Hotel Sector series, there are tremendous opportunities for value creation in the European hotel sector today. A successful value creation investment strategy starts with understanding how demand has changed and how to transform the property to better meet that demand. Given rising demand for sustainable hotels from the growing number of eco-conscious travellers and increasingly stringent sustainability requirements, successful investment will likely involve some type of sustainability-orientated value creation and implementation of sustainability-focused operational tactics.

Sustainability yields environmental benefits—energy and water efficiency, carbon emissions reduction, and waste minimisation. It yields social benefits—improving the health and well-being of guests, employees, and local communities. And it yields financial benefits, as an opportunity to increase both hotel performance and value at asset disposition. To realise those benefits, having an experienced investment partner with a track record of sustainability-orientated value creation in the European hotel sector is key to optimising decisions around property selection, capital improvement, operating structure, and operations.

Risk Considerations

Investing involves risk, including possible loss of principal. Past Performance does not guarantee future return. All financial investments involve an element of risk. Therefore, the value of the investment and the income from it will vary and the initial investment amount cannot be guaranteed. Potential investors should be aware of the risks inherent to owning and investing in real estate, including value fluctuations, capital market pricing volatility, liquidity risks, leverage, credit risk, occupancy risk and legal risk. All these risks can lead to a decline in the value of the real estate, a decline in the income produced by the real estate and declines in the value or total loss in value of securities derived from investments in real estate. International investing involves greater risks such as currency fluctuations, political/social instability, and differing accounting standards. Integration of sustainability considerations and/or environmental, social and governance (ESG) factors is qualitative and subjective by nature. There is no guarantee that the criteria used, or judgment exercised, will reflect the beliefs or values of any particular investor. There is no assurance that any strategy or integration of sustainability considerations and/or ESG factors will be successful or profitable.

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