CORNELL PETER AND STEPHANIE NOLAN SCHOOL OF HOTEL ADMINISTRATION
CENTER FOR HOSPITALITY RESEARCH
PILLSBURY INSTITUTE FOR HOSPITALITY LEADERSHIP

Consolidating the $50 Billion U.S. Short-term Rental Market:

How PropCos Can Help Best-in-Class OpCos Scale and Institutionalize the Asset Class

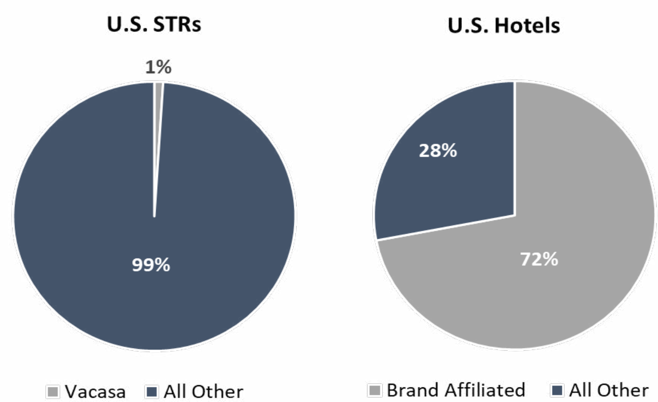
by F. Philip Lólis, Mike Scott, and Clay Dickinson

Over 72 percent of all hotels in the United States are affiliated with large brands like Marriott, Hilton, IHG, and Hyatt. In contrast, the largest operator in the short-term rental (STR) market, Vacasa, manages less than 1 percent of the total market. (See Exhibit 1.) With around $53.5 billion in gross booking value, or about 25 percent of the entire U.S. lodging industry, the STR market presents an enticing consolidation opportunity.[1]

[1] Phocuswright, Global Short-term Rentals 2022-2026 (accessed Apr. 21, 2023).

EXHIBIT 1

Market share by STR units versus market share by hotels



Source: Jan Freitag, For Hotels the Future Is Branded. Or Is It?, COSTAR (Mar. 18, 2021, 9:45 AM), https://www.costar.com/article/1364111080/for-hotels-the-future-is-branded-or-is-it.; Vacasa Analyst Day Presentation (Oct. 2021).

Unsurprisingly, billions of dollars have flowed into tech-enabled, asset-light STR operators in recent years to pursue this opportunity without much success to date. Over 20 years before these operators entered the market, another company, called ResortQuest, tried to consolidate the STR market and after failing to do so was eventually sold in parts to various acquirers. Despite these attempts, we believe the opportunity to consolidate exists, but that it will follow a pattern that is similar to the consolidation of the traditional lodging industry.

Part of the journey requires building strong brands and operating capabilities, but that in and of itself requires significant time and capital, especially in lodging, where distribution and, increasingly, distinctive guest experiences are paramount. Most global hotel companies originally built their brands using a capital intensive, asset-heavy approach, owning and operating the assets. Over time these hotel companies were able to spin off real-estate assets into REITs and scale the management and franchise segments faster and more cost effectively under established brands. The evolution of STRs may be similar, as capital is now flowing out of prematurely asset-light operators and into related property company and operating company structures (PropCo/OpCo) that replicate the more asset-heavy approach.

The OpCo is a venture-backed, tech-focused company with an asset-light business model. The PropCo is an investment vehicle that owns the property that the OpCo's business revolves around. The OpCo operates the assets on behalf of the PropCo.

The timing to combine these PropCo/OpCos is opportune given the maturation of the distribution landscape, improvements in technology, and the post-pandemic consumer demand tailwinds. These new PropCo/OpCos will likely create new brands and provide opportunities for existing lodging brands to consolidate the STR market.

PropCo/OpCo Structures Create Flywheels for Investors, Attract Institutional Capital, and Allow STRs to Consolidate as Have Other Real Estate Asset Classes.

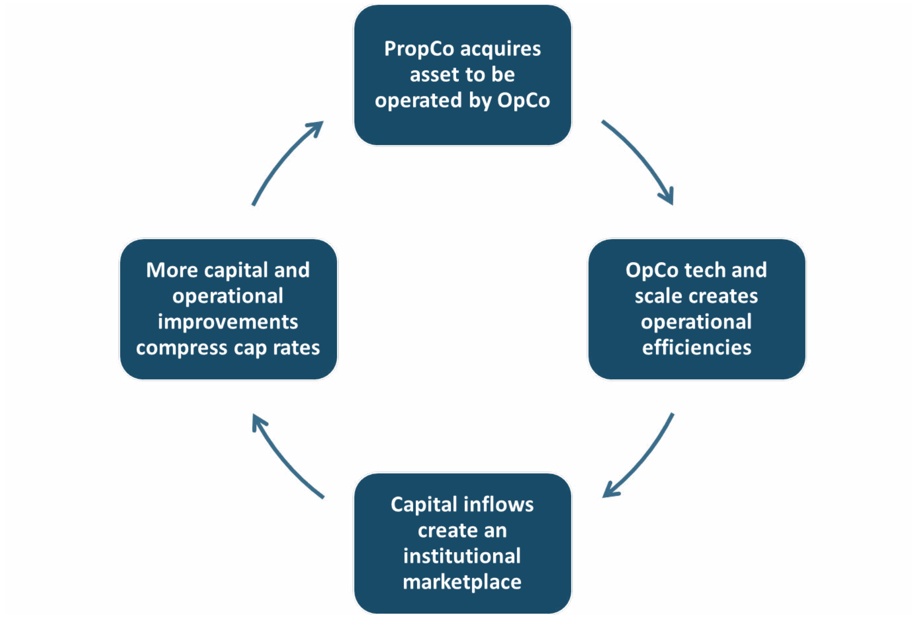
For most of the 20th century, hotels were generally owned and operated by the same entity. The alignment of interest gave the hotels the necessary control to maximize guest satisfaction and ensure consistency of the product, allowing them to build the strength of their brands.

By raising a separate PropCo entity alongside the OpCo, the next wave of tech-enabled STR OpCos will be able to control the operating assets without investing expensive and dilutive venture dollars into real estate. Instead, the PropCo will own the real estate, replacing individual property owners, each of which has their own nuances and headaches, with long-term, strategic partners. Growth, then, will be tied to the PropCo, whose investors would reject unprofitable acquisitions, thereby preventing overextension. Finally, then, OpCo technology can leverage economies of scale and product consistency to drive efficiencies that improve service and maximize guest experience across an entire portfolio, thus establishing and scaling a strong hospitality brand.

The PropCo investor also receives outsized benefits relative to traditional real estate investments. The assets, namely single-family homes, will have increased property value thanks

EXHIBIT 2

PropCo/OpCo flywheel



to enhanced NOI and compressed cap rates from the STR model, as well as efficiencies generated from the OpCo. Additionally, the PropCo investor could negotiate warrants in the OpCo or invest in the venture fund leading the OpCo to participate in higher, risk-adjusted returns. Essentially, the PropCo and OpCo structure creates a flywheel effect. (See Exhibit 2.)[2]

The benefits of the PropCo/OpCo depicted in Exhibit 2 should attract additional institutional capital, increasing scalability. The problem for would-be institutional investors today is the fragmentation of ownership, which precludes the larger check sizes usually required to attract these institutional investors. This is typical of the earliest stage of the niche asset class capital-allocation cycle, as typified in multi-family housing, student housing, and other commercial real-estate asset classes. Take single-family rentals, for example. A decade ago, after the Great Financial Crisis, Invitation Homes identified an opportunity in the market to purchase homes at discounted prices and began doing so at scale, creating a multi-billion-dollar REIT. Other institutional investors took notice and flooded the sector with capital, making financing easier and increasing valuations. Today, institutional investors own at least 5 percent of the entire single-family-rental asset class in the U.S., and that share continues to grow.[3] Interestingly, as single-family-rental REITs helped drive prices of single-family homes up, it also made STR portfolios more attractive because of the model's ability to compress cap rates by generating higher revenue per unit and therefore a higher NOI, if done effectively.

In an interview, Steve Milo, CEO of Vtrips, agreed that PropCo/OpCos will consolidate the industry.[4] He believes the institutionalization of the asset class is coming eventually, and that once a stabilized cap rate is discovered for STRs, REITs will be created out of the PropCo/OpCos.[5] However, with more capital at stake, these structures require even more leadership and expertise to execute properly.

2 See also Daniel Fetner & Ryan Freedman, The Great "PropCo" Opportunity, Alpaca VC (Jan. 4, 2022), https://medium.com/alpaca-vc/the-great-propco-opportunity-f84d9fb70032.

3 Jeff Adler, *et al.*, Build to-Rent Fuels Growth in Institutional Single-Family Rental Market, Yardi Systems (July, 2022).

4 Interview with Steve Milo, CEO Vtrips (Apr. 15, 2023).

5 *Id.*

EXHIBIT 3

Overview of short-term rental manager venture investments since 2021 to today

Source: Pitchbook Data

Billions of Dollars of Venture Capital Has Backed Asset-light, Tech-enabled OpCos Aiming to Consolidate the STR Market, but These Players Have Repeated Some of the Same Mistakes that ResortQuest Made.

Like ResortQuest, many new OpCos entered the market with aspirations of rapid consolidation. The main difference this time has been the sheer scale of capital deployment. (See Exhibit 3.) Despite massive investment, these new players have yet to successfully create a nationally recognized brand and consolidate the STR market. Instead, Vacasa and Sonder, the two OpCos that have raised the most capital and that both went public via SPACs, have struggled in public markets.

So, what's going on here? Well, history appears to be repeating itself. Some of the issues ResortQuest faced look similar to those facing VC-backed players today.

First, the "growth at any cost" mentality causes a lot of pain. The pressure to grow led ResortQuest to pursue acquisitions at high multiples, and the subsequent integration of these properties from a tech and financial standpoint proved challenging and expensive. Similarly, Vacasa has made large, headline-grabbing acquisitions of rivals like Wyndham Vacation Rentals for $166 million in 2019[6] and TurnKey Vacation Rentals for $619 million in 2021.[7] While Sonder has not been as acquisitive, it has entered into master lease agreements to fuel its growth. Now that the 2021 boom year has come and gone and investors value profitability instead of growth for growth's sake, Vacasa's and Sonder's stock prices have correspondingly been hit hard, hurting their brand equity as well.

[6] Vacasa Finalizes Purchase of Wyndham Vacation Rentals, Vacasa (Oct. 23, 2019), https://www.vacasa.com/news/vacasa-finalizes-purchase-wyndham-vacation-rentals.

[7] Dennis Schaal, Vacasa Paid $619 Million for TurnKey Vacation Rentals in Mostly Stock, Skift (Nov. 30, 2021, 9:30 AM), https://skift.com/2021/11/30/vacasa-paid-619-million-for-turnkey-vacation-rentals-in-mostly-stock/.

Second, due to the absence of scale, STR guests still do not associate with any brands on the supply side. To build the brand equity that the large hotel companies enjoy, an STR operator must have an obsessive dedication to guest experience, consistency of product, and scale. ResortQuest failed to build a brand in part because they never had complete control of their operations. Asset-light OpCos need to plan for individual property owner retention in addition to distribution and guest acquisition. While a centralized, corporate OpCo would increase consistency and quality of product, it offers little value for individual property owners in terms of relationships and flexibility, an important factor for them, in addition to income generation. Negotiating layout, furnishings, and other physical requirements on a property-by-property basis is not efficient and limits scalability. Accordingly, Vacasa has seen above industry average property owner churn on its platform.[8] Meanwhile, Sonder's balance-sheet-heavy master-lease strategy gives it more control over its properties, but its investors don't capture the value it creates through refurbishing and improving the property.

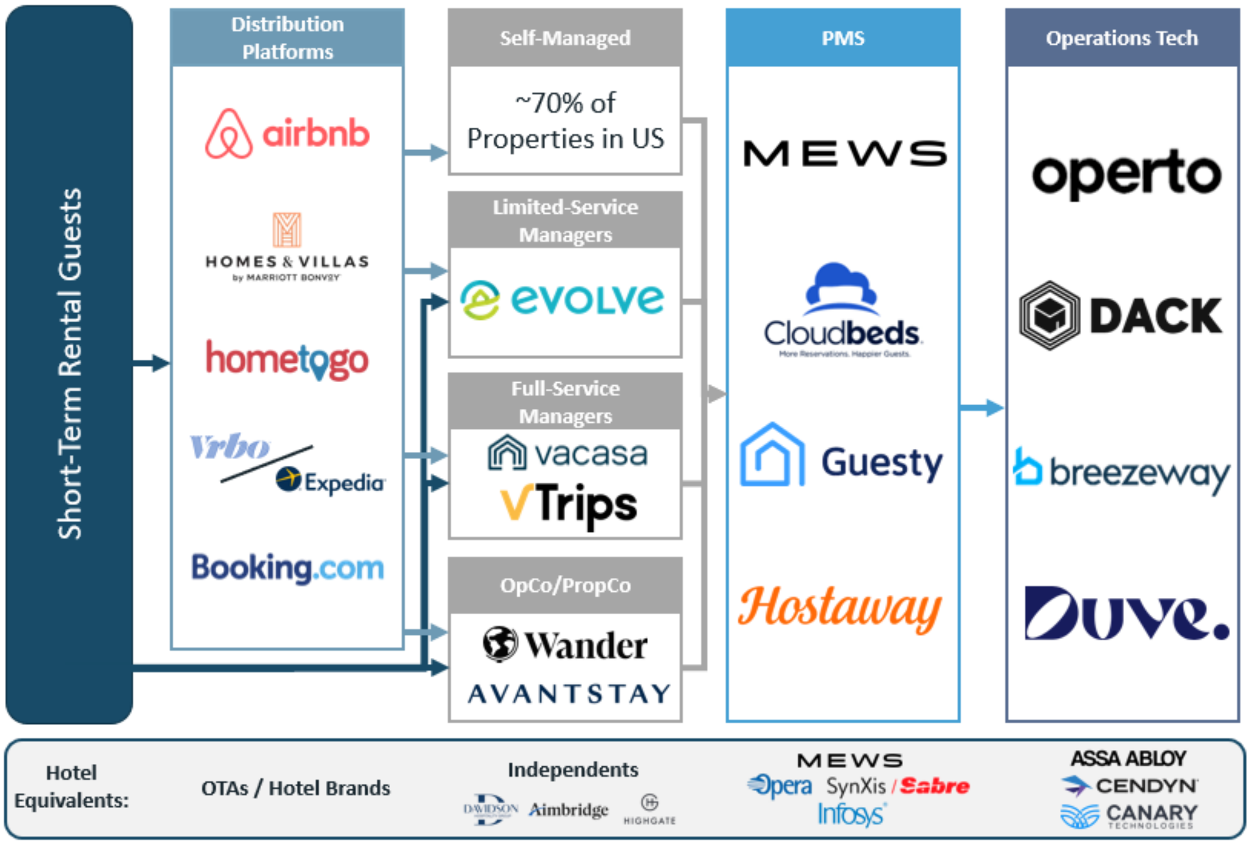
These OpCos lacked a PropCo partner from inception. A PropCo partner has a pecuniary interest in the growth of the OpCo's operations and therefore would more than likely negotiate some control or veto right over acquisitions. This would mitigate the OpCo's temptation to grow inefficiently but quickly. On the other hand, the OpCo's leadership would likewise negotiate the delegation of day-to-day management and control of the properties, including branding, design, and improvements. So, this would also mitigate the inefficient and inconsistent piecemeal approach of managing properties for unrelated third parties. Each PropCo/OpCo formation agreement will have varying terms, but the best ones will be able to align the interests of owner and operator.

A *de novo* OpCo that has joined with a PropCo partner from inception should be able to avoid many of the challenges associated with executing and scaling the business model. But hospitality is hard. Regardless of corporate structure employed, without a doubt, the companies that will consolidate the STR space must be relentlessly focused on guest experience and mastering the balance between offering unique properties while providing consistent quality, service, and convenience. (Another challenge to scaling, which is beyond the scope of this writing, is the changing regulatory landscape for STRs.) While there will be no shortcuts to building a nationally recognized STR brand, recent trends have created one of the most favorable times to try to do it.

[8] Dennis Schaal, Vacasa Sees Increase in Properties Leaving Its Platform, Skift (Mar. 14, 2023, 7:05 PM), https://skift.com/2023/03/14/vacasa-sees-increase-in-properties-leaving-its-platform/.

EXHIBIT 4

Overview of the short-term rental ecosystem



PropCo/OpCos Have a Historic Opportunity for Consolidation Given the Maturation of the Distribution Landscape, Improved Tech Stack, and Post-Pandemic Consumer-demand Shifts.

Airbnb was born in 2007 and captured the public consciousness by making it easier than ever for individuals to make extra income by renting their entire home or just a spare room to a stranger. At the time of this writing, Airbnb is the second most valuable travel company in the world (behind Booking). It has become synonymous with the STR market to the extent that, even though Airbnb is an OTA that only handles distribution, many people outside of hospitality and travel see it competing with owners and operators. For example, a recent TechCrunch article claimed that Roami, a full-service STR operator, was "tak[ing] on Airbnb" and that Roami could "do better than Airbnb."[9] The reality is that the STR space is much more complex and fragmented. (See Exhibit 4.)

Although Airbnb does not actually own or operate any STRs, the quality and consistency of the supply it distributes has become increasingly important. For example, while professional property managers represent only 1 percent of all Airbnb hosts, they manage 23 percent of available listings and generate 28 percent of total revenue.[10] This represents Airbnb's creeping pivot away from non-professional hosts.

Booking and Expedia focus more on a professionally managed STR supply (ironic given that Expedia's Vrbo once stood for "vacation rentals by owner"). In the U.S., Airbnb made up 18 percent of all guest check-ins for professionally managed properties in 2022, but only 11 percent of revenue, whereas Vrbo represented 21 percent of all guest check-ins and 21 percent of revenue.[11] Despite Airbnb's powerful brand equity among the general public, its competitors have provided more effective distribu-

[9] Haje Jan Kamps, Roami Takes on Airbnb with Creativity, Grit and $14m, TechCrunch (Mar. 7, 2023, 6:01 AM), https://techcrunch.com/2023/03/07/sextant-stays-becomes-roami/.

[10] Best Airbnb Property Management Companies in the US for 2022, AirDNA (Apr. 19, 2022), https://www.airdna.co/blog/the-best-airbnb-property-management-services.

[11] Melanie Brown, Insights into the U.S. Vacation Rental Market, Webinar (KeyData and Oppenheimer & Co., Apr. 20, 2023).

tion for professional managers. The increased competition demonstrates the maturation and evolution of the distribution landscape.

Similarly, the STR tech stack has matured as well. Today, there are property management systems (PMS) and operations applications that are built with STRs in mind. For example, Guesty has built a centralized PMS exclusively for STRs to store booking data, channel management, and guest communications. The PMS acts as a central nervous system, and on top of that a guest management layer is being built with tech vendors like Operto and Breezeway offering suites of products ranging from keyless digital entry to digital authorizations to guest communications and labor management. It's easier than ever for STR OpCos to maximize occupancy and returns.

The evolving STR tech stack also includes new companies like Way that are dedicated to creating and curating unique, local experiences. Way is a B2B SaaS platform that enables consumer brands to launch experiences and activations in-house in a white-label manner. By leveraging Way or other, similar vertical software, STR OpCos can scale while still maintaining the uniqueness and localness that makes them attractive to travelers.

Finally, the COVID-19 pandemic has turbo-charged, and perhaps permanently changed, the accommodations industry in several ways. First, the emergence of virtual technologies and remote work has provided a tailwind for STRs by creating a class of nomadic employees. These digital nomads increasingly blend business and leisure ("bleisure") travel, substantially increasing the average length of stay per trip. As the extended-stay lodging sector has shown, longer lengths of stay typically require larger, more residentially oriented accommodations. STRs are particularly well suited to meet these requirements and are, unsurprisingly, the most sought after lodging category for bleisure travel.[12] Second, 75 percent of travelers in U.S. now seek unique stays for their vacations, and most of these travelers believe that STRs are more likely to satisfy this requirement.[13] These two trends created massive demand resulting in STR's share of gross booking value for lodging in the U.S. going from 17 percent in 2017 to 25 percent in 2022.[14]

The combination of public awareness, a mature distribution landscape, an improved tech ecosystem, and potentially permanent consumer demand shifts has created a historic opportunity for PropCo/OpCos to consolidate STRs.

A New, World-class Hospitality Brand Will Emerge from the Consolidation of STRs.

A handful of PropCo/OpCos are already coming to market, like Wander, AvantStay, and Heirloom. Eventually, the winners in this space can create world-class hospitality brands as renowned as Marriott, Hilton, and Hyatt in the traditional lodging space. In fact, these same trends are expected to create growing opportunities in the STR market for these global hotel brands themselves. Just like the traditional lodging industry, once the STR industry becomes more consolidated, the PropCo/OpCo will likely gradually split apart, creating an asset heavy REIT that owns the real estate (e.g., HOST) and an asset-light franchise and management company (e.g., Marriott). Time will tell who will best execute on the opportunity, but it will be exciting to watch and even more exciting to participate in as an investor. ■

[12] Global Alternative Accommodation Market Trends, Phocuswright (Jan. 2022).

[13] *Id*.

[14] *Supra* note 1.

ABOUT THE AUTHORS

F. Philip Lólis (*Thayer Ventures*) is a venture capitalist, entrepreneur, and attorney. After graduating from the University of Virginia, Philip covered Latin America as an investment banker for Credit Suisse. Following that, he founded an upscale car-sharing platform called Miami Luxury Cars, which generates around $6 million in yearly revenue today. After exiting, he joined Thayer Ventures in 2022, where he focuses on bridging the gap between technology and travel. Philip also holds a Juris Doctor from the Florida International University College of Law, where he graduated Magna Cum Laude.

Mike Scott (*Derive Ventures*) co-founded Derive Ventures in 2021 and currently serves as a Managing Partner. Prior to co-founding Derive, Mike spent over 3 years as a private equity investment professional at KSL Capital Partners. Prior to KSL, Mike was an investment banker in J.P. Morgan's Real Estate, Gaming and Lodging group. Mike currently serves as an advisor to Paradero—an experiential hospitality brand, operator, and owner in Mexico. He graduated from the University of Michigan and holds a Bachelor of Business Administration from the Stephen M. Ross School of Business.

Dr. Clay B. Dickinson (*Florida International University*) recently joined Florida International University's (FIU) Chaplin School of Hospitality and Tourism Management and the Hollo School of Real Estate in the Chapman College of Business as a full-time professor focused on teaching real estate investment, feasibility, valuation and asset management. Prior to joining FIU, Clay worked in the hospitality and real estate industries for almost four decades, with much of that time being focused on the Caribbean and Latin America (CALA) region. During his professional career, Clay engaged in many aspects of the hospitality industry, including feasibility and valuation, corporate strategy, information technology, real estate development and investment/transaction advisory and asset management with such firms as KPMG, IHG/(Holiday Inn Worldwide), EDS and JLL. Clay earned his Doctor of Business Administration from FIU in July 2022 and holds additional post-graduate degrees from Georgia Tech, ESADE and ASU/Thunderbird School.

Disclaimer and Disclosure

The views and opinions of authors published on this site do not necessarily reflect those of FIU, Thayer Ventures, or Derive Ventures. Reference to any specific products, processes, or services by trade name, trademark, manufacturer, or otherwise does not necessarily constitute or imply its endorsement, or recommendation. Nor shall any information or statements contained in this article be used for the purposes of advertising, or to imply an endorsement or recommendation.

The authors have beneficial positions in the shares of Mews, Canary Technologies, Inspirato, Sonder, Operto, and Way, either through stock ownership, convertible note agreements, or other securities. The authors wrote this article themselves, and it expresses their own opinions. The authors are not receiving compensation for the article.

Center for Hospitality Research Reports

Linda Canina, Dr. Michael Dang Director,
Center for Hospitality Research
Nicole McQuiddy-Davis, Program Manager, Managing Editor
Shana K. Claar, Program Assistant, Centers and Institutes
Glenn Withiam, Contributing Editor

Kate Walsh, Dean, E.M. Statler Professor
Cornell Peter and Stephanie Nolan School of Hotel Administration
Statler Hall
Cornell SC Johnson College of Business
Ithaca, NY 14853
607-254-3383 • www.chr.cornell.edu • Volume 23, No. 7

CHR Advisory Board

Pillsbury Institute for Hospitality Leadership

Robert Gregor, Esq. '00, JD '07 Executive Director
Linda Canina, Academic Director, Professor of Finance
Michelle Ciaschi, Program Manager

Kate Walsh, Dean, E.M. Statler Professor
Cornell Peter and Stephanie Nolan School of Hotel Administration
Statler Hall

Cornell SC Johnson College of Business
Ithaca, NY 14853
607-254-3383 • https://sha.cornell.edu/faculty-research/centers-institutes/pihe/

Pillsbury Institute for Hospitality Leadership Advisory Board