Hong Kong Serviced Apartments

Room to Expand:
Can the Industry Accommodate More Players?

A HOME AWAY FROM HOME

It's Friday night and at the ACTS Rednaxela in the Mid-Levels, the smell of barbeque fills the terrace of a duplex suite where an executive is entertaining friends around a private pool after a busy week in the office. Over on Kowloon side, a summer intern at a banking firm located in ICC relaxes in their fully-furnished studio at CHI’s 393 residence in Yau Ma Tei. It is a comfortable home away from home during their stay in Hong Kong before they return to Shanghai after the summer months.

The past decade has seen tremendous growth in the serviced apartment industry in this vibrant city, which has come a long way since they first started appearing as 'aparthotels' in Hong Kong during the 1980’s. From plush duplexes, hotel-style suites, to chic designs and basic units providing maid services, this sector now caters to a diverse and wide range of clientele accommodating to a wide range of needs and desires.

DRIVING DEMAND

Serviced apartments serve as both a comfortable and convenient choice for both short and long term stays and for guests with both limited and extended budgets. In Hong Kong, typical monthly accommodation budgets range from HKD20,000 at the junior level, HKD60,000-150,000 at middle management and over HKD150,000 for senior managers. Hong Kong remains a strong magnet for expats, with a large number of regional headquarters and offices located in the city and an increasing number of foreign nationals arriving for employment or investment purposes. Typically from the US and Europe, an increasing number of arrivals are also coming from Mainland China and South East Asia, with shorter stays and are frequent visitors to MICE events. Hong Kong is still one of the most favourable IPO destinations for Mainland companies to raise funds and has been the world's biggest IPO market for the last two years. Despite continued recent turmoil in Western financial markets, we expect the Asia region to remain relatively strong with Hong Kong maintaining its regional status and as the gateway to China. For domestic users, the narrowing gap between rentals for standard and serviced apartments makes them increasingly attractive, especially for those taking time to purchase in this tight market. Occupancy rates, which have averaged 90-95% in 2011, have also been boosted by unfortunate events such as the earthquake and tsunami in Japan that occurred earlier this year and turmoil in the Middle East, prompting occupants to take a sit-on-the-fence approach before making longer-term commitments.
COST OF SERVICE
The existing supply of serviced apartments in Hong Kong currently stands at approximately 17,000 units, with the largest concentration of supply being located in Central and Wan Chai. This figure includes those managed by small operators such as CityLoft to the luxurious living style offered at Four Seasons and Pacific Place Apartments. Average rentals per square feet vary from HKD39-69/psf/month in Central / Admiralty to HKD40-50/psf/month in Western district, Wan Chai and Causeway Bay. Monthly rates vary from HKD6,500 per month for a 200 sq. ft. converted studio in Sheung Wan to HKD40,000 for a 1,050 sq. ft. one bedroom suite at Fraser Suites to HKD200,000 for a 2,650 sq. ft. three bedroom suite in Pacific Place Apartments. Although there are quality serviced residences located in the New Territories such as Hyatt Regency in Sha Tin and Gold Coast in Tuen Mun, rental rates per square feet drop substantially compared to those in more prime locations. With the buoyant local economy and limited supply, rents rose 2.4% QoQ as of May 2011 across the board. With renewed concerns about global economic growth and the subsequent effect on hiring expectations, we anticipate rentals to remain largely stable over the next 12 months, with a 3% decline in the luxury residential leasing market. Historical data for rental trends show that serviced apartments are relatively less volatile compared to luxury residential in downturns, with rentals for the latter dropping almost 10% more during the peak of the 2008 financial crisis, an important factor for investors as we enter another period of global uncertainty.

<table>
<thead>
<tr>
<th>Area</th>
<th>Average Rental Range (HKD / psf)</th>
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<tbody>
<tr>
<td>Central / Admiralty</td>
<td>39-69</td>
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<tr>
<td>Southern</td>
<td>52-55</td>
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<tr>
<td>Eastern</td>
<td>49-52</td>
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<tr>
<td>Western</td>
<td>40-50</td>
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<tr>
<td>Wan Chai / CWB / Happy Valley</td>
<td>40-50</td>
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<tr>
<td>Kowloon</td>
<td>40-50</td>
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<tr>
<td>Others</td>
<td>25-30</td>
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<tr>
<td><strong>Hong Kong</strong></td>
<td><strong>41-61</strong></td>
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Source: Colliers International

YIELD ATTRACTION
Serviced apartments have become an enticing proposition with attractive yields compared to other asset types in Hong Kong. Yields averaged 4.8% for the period January 2010 to July 2011, compared with just over 3% for Retail and Grade A office and 2.9% for Luxury Residential. En-bloc transactions started to gain momentum in 2010 with Ovolo, an up-scale local operator, acquiring Kush 111 and Kush 222 in Western district and also the Olympic Terrace hotel in Kowloon as part of their expansion and adding 139 keys to their portfolio. Domus Mercury, located in Tin Hau was also acquired by a local investor and rebranded to Equinox for just under HKD300 million, with an estimated initial passing yield of 4.5%. International brands, including Fraser Suites also entered the foray in 2008, operating serviced suites that were previously converted from residential units. In June 2000, the Hong Kong Town Planning Board dropped ‘Serviced Apartment’ from the land use list, with serviced apartments now being able to be developed under both residential (flat) and commercial (hotel) use. Both types of development can cater to different business models. Despite the operational challenges, units under residential have the option of being sold strata-title while those under hotel can only be sold en-bloc and are subject to more stringent controls with regards to safety and security.

ROOM FOR MORE?
With both local and international operators recognising the potential of serviced apartments, the market landscape has become increasingly crowded and competitive. As the industry matures, occupants are becoming more demanding in terms of both quality and service. Operators are recognizing this, with De Ricou in Repulse Bay vacating all existing tenants by February 2012 in order to renovate and upgrade for a re-opening in 2013. The tight supply situation in Hong Kong means that it is difficult for players such as Fraser Suites and Ascott to expand even if they wanted to. At the same time, demand for serviced apartments remains high. Although the three main areas of Central, Mid-Levels and Tsim Sha Tsui will always remain popular, a broadening clientele base and a widening gap between corporate budgets and rentals means we also expect a
continuation of the trend to decentralized areas. With the limited supply of Grade A office space, the changing nature of the CBD and emergence of other core office areas (West Kowloon, Kowloon East) this will also shape the serviced apartment industry as well as improvements to Hong Kong’s infrastructure, where we will see the opening of the extension of the Island MTR line to Western district in 2014.

CHI International, who has been very successful in spotting up-and-coming areas as in the case of the development of West Kowloon, remains optimistic. Currently operating four properties containing 100 units, they are building another in Wan Chai which is expected to be completed in 2013 and aim to add another 400 units within the next five years. To fund their expansion plans both in Hong Kong and on the Mainland, we may see a number of operators offering their properties for sale and leaseback agreements to free up cash available to capitalise on future opportunities in the sector. As Hong Kong is expected to maintain its relatively strong economic position with a sustained inflow of visitors and expats, there is still space for the serviced apartment industry to accommodate more players, especially those who are looking to fill the latest niche, identify the latest trend or spot the latest up-and-coming area.

**FUTURE DIRECTION**

**Possible drivers of future direction:**
- Into decentralized office areas
- Expansion of the CBD will expand the reach of serviced apartments
- Potential industrial buildings conversion
- Emerging areas: Kowloon West, Kowloon East Quarry Bay, Sha Tin
- Extension of the Island MTR line to Western district is expected to be completed in 2014.
FEATURE:

SERVICED APARTMENT FOCUS – ACTS: HAPPY VALLEY

Location: 41 Yik Yam Street, Happy Valley, Hong Kong
Opened: October 2008

Tucked away in the corner of Yik Yam Street in Happy Valley, lies a revitalized old tenement that was brought back to life when ACTS developed the first of its three serviced apartment properties in Hong Kong.

The property, which was completely redesigned by Edge Design Institute, is a testament to the diversity and range of choices now available to those in Hong Kong who are looking for short term stays without compromising on comfort and style. Although space is limited in this city, it also shows the potential that can be unleashed by operators and developers with some flair and creativity.

A distinctive feature is the dark louvre windows, which strikes a sharp contrast to the neighbouring developments. There are only five suites, each sized at 750 sq. ft. with high ceilings and ceiling fans to keep extra cool during the hot and humid summer months.

Guests may catch the game on the 37” plasma television which is connected to Apple TV, turn up the action watching a movie on the Bose entertainment system, soak in the bathtub listening to their favourite tunes after a long day using the iPod dock or take a quick rain shower before hitting the town to spend their entertainment credits. Energy levels permitting, residents can also keep fit with membership to fitness clubs.

ACTS also operates the ACTS Rednaxela in Mid-Levels and The Archive in Wan Chai.