JONES LANG LASALLE HOTELS

Serviced Apartments

In this issue

Foreword

Serviced apartments have been growing in popularity as an alternative accommodation concept over the past decade. However what is most interesting to investors is how serviced apartments differ from hotels in terms of their product offering, valuation considerations and investment criteria.

This edition of Hotel Topics focuses on the serviced apartment sector and attempts to answer some of the questions about this rapidly expanding sector.

The serviced apartment product has evolved dramatically from its origins in the US in the early 1980s, although is varied throughout different regions of the world. Following the US lead, the concept has taken off in Australia and Asia, although has not flourished to date in the European market. We examine why and the major players and ownership structures in place across the globe.

The higher occupancy levels, lower development costs as well as lower operating costs serve to boost profitability in this market. Although value is also driven by factors typical to the hotel market such as location, demand profile and competitive supply.

There are nuances in the serviced apartment market that are different to the full-service sector which potential investors must be aware of. Our investment guide to the serviced apartment sector highlights the "dos" and "don'ts" for prospective buyers.

I hope you find this issue interesting and useful. As always, I would appreciate any comments of feedback be directed to anna.town@ap.joneslanglasalle.com.

Peter Barge
Chairman & CEO
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Serviced Apartments – A Global Comparison

A benchmark of different serviced apartment product types across the globe. Melinda McKay, Senior Vice President in Chicago, investigates.

It seems there is one segment of the tourist accommodation market that can weather economic downturns and contraction in visitor numbers better than other segments – serviced apartments. In this article, we explore the characteristics of the serviced apartment market and their relative product offering around the world. We also review the relative market maturity in each region and discuss why Europe is only now adopting an investment product that has witnessed immense popularity in the Americas and Asia Pacific.

Serviced apartments, corporate apartments and extended-stay hotels are relatively recent products in the lodging industry that have gained tremendous popularity over the last decade, thereby representing a significant competitor to conventional hotels in many markets around the world. This segment has grown (to varying degrees around the world) from relatively humble origins as a small single market for longer stay travellers using residential property, to a fully developed, multi segmented mature market attracting longer stay guests and an increasing proportion of shorter stay guests.

Jones Lang LaSalle Hotels interviewed several US extended-stay operators asking them to identify why visitors were increasingly moving towards extended-stay accommodation over the alternatives. The primary reasons given were as follows:

- "Home away from home" feel of extended-stay properties;
- Ability to accommodate family on extended stay business trips, reducing the necessity for return trips home;
- Competitive cost;
- Convenience.

In order to accurately benchmark the different types of serviced apartment complexes around the world, three broad categories have been developed: budget, mid-tier and upper-tier. Figure 1 has been compiled to provide an analysis of the varying inclusions featured in the three tiers of serviced apartment products. In most cases, serviced apartment complexes comprise a majority of one-bedroom or studio suites, particularly where the primary focus is on the corporate traveller. The units generally include a small kitchen, bathroom and living area.

Figure 1: Different Serviced Apartment Product Types

	Americas	Asia Pacific	Europe
Budget	• Kitchen area with full-size refrigerator and microwave • Vending machines • Coin-operated laundry facilities • Voice mail with data ports • Cable TV	• Refrigerators • Air-conditioning • Ironing	• Weekly to bi-weekly housekeeping • Coffee services • Some kitchen services • Laundry machines
Mid-tier	• Data ports • Iron and ironing board • Laundry services • Complimentary breakfasts • Fully equipped kitchens • Fitness centres • Guest convenience pantries • Weekly housekeeping	• Fully equipped kitchens with dishwashers • Exercise facilities • Cable TV • Business centres • Internet access • In-room safes • Washer and dryer in unit	• Some housekeeping • Daily housekeeping • Laundry service • Coffee services • Some kitchen facilities • Complimentary breakfast
Upper-tier	• Fully equipped kitchens • Daily hosted receptions • Guest social gathering places • Libraries • Laundry services • 24-hour business service • Two phone lines • Fitness centres and spas • Voicemail • Internet access • Daily housekeeping	• Fully equipped kitchens • Guest lounges • Spa services • Grocery services • On site restaurants • Restaurant delivery services • Business centers • In-room laundry • Regular housekeeping • 24-hour amenities	• Housekeeping • Fully equipped kitchens • Washer and dryer in unit • Lounges • Fax and internet services • Fitness centres • Enhanced entertainment systems • Dry cleaning services • Enhanced business services • On-call doctors

Source: Jones Lang LaSalle Hotels

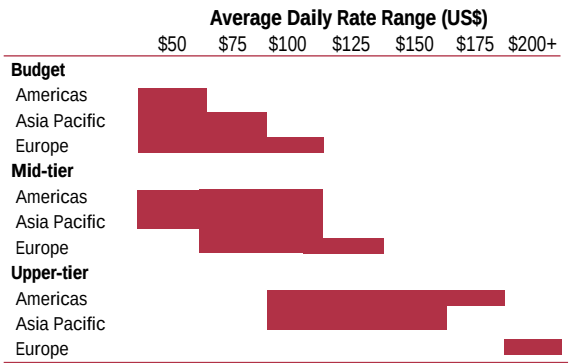
The following becomes apparent when comparing the different categories around the world:

- Budget – The US seems to have a more developed budget class, the majority of which is targeted at corporate travellers. In Asia Pacific and Europe, budget-class serviced apartments appear more targeted to traditional longer-stay travellers, with the exception of the branded properties.
- Mid-tier – The US appears to have the most sophisticated and developed mid-tier class. In certain Asia Pacific countries (such as India and Thailand) properties offer upper-tier amenities at mid-tier prices.
- Upper-tier – Facilities in the Asia Pacific are world-class and reminiscent of full-service resorts, with certain operators, such as Ascott, providing upscale environs. This compares to the Americas where the focus is on business convenience, although often some form of guest social facilities such as a BBQ or cocktail reception is provided.

Europe: highest average room rates.

As Figure 2 demonstrates, Europe generally tends to lead the market in price point terms for serviced apartments. This not surprising given the limited availability of the product, along with the generally higher hotel rates achieved throughout the region compared to the rest of the world. Lower pricing appears evident in the Asia Pacific upper-tier segment, however this is more the result of exchange rate influences and notable supply increases in certain markets.

Figure 2: Benchmark of Serviced Apartment Average Daily Rates



Source: Jones Lang LaSalle Hotels

Americas – a Fully Evolved Market

Serviced apartments or 'extended stay' accommodation as they are termed in the US, was introduced during the early 1980s, with Marriott's Residence Inn dominating the market for many years. It was not until the mid to late 1990s that the concept took hold, expanding exponentially. According to Smith Travel Research (STR), the number of extended stay rooms in the US market increased fourfold from 1994 to 1999 and now represent approximately four percent of total commercial accommodation. During this period, emerging economy, mid-market chains and franchise operators drove strong growth, and most of the major US hotel chains began operating a range of brands. It is currently estimated that the lower graded serviced apartments now account for 60 percent of total supply in the sector. The US now features a highly developed serviced apartments market at all three levels (upper-tier, mid-tier and budget), with corporate travellers the primary target market.

Serviced apartment occupancy holds firm above hotels.

During the last 18 months, the US lodging industry has been adversely affected by the economic downturn and the sharp decline in travel due to September 11, 2001. However, the extended-stay segment has held occupancy in the 70 percentile range compared with all hotels in the US where occupancy has languished below the mid 60 percentile range. However, this is at a price point, with the average daily rates (ADR) for serviced apartments as much as 50 percent lower than at traditional hotels.

While starting off with its roots in the corporate sector, more recently extended stay accommodation has begun to appeal to leisure travellers. This shift can be attributed to a general trend towards increasing vacation demand, the price advantages over a similar hotel product and the additional kitchen amenities for families. The price sensitivity of corporate travellers (given the weaker economic climate) has also contributed to demand growth from this sector, coupled with a boost in temporary employment contracts.

Given the growth in demand for this style of accommodation, construction continues to increase at a rapid rate. In 2002, limited service giant Extended Stay America increased construction starts to 24 from 15 in 2001, and intends to increase the rate further to 25 new starts in 2003. Holiday Inn's upper-end Staybridge Suites intend to open 11 new properties by the close of 2002. This builds on their remarkable growth rate, building the portfolio from zero to 50 properties in only four years.

US Franchise Systems expects to open a total of 20 new Microtel Inn and Suites properties by year-end 2002, a soft year in comparison to its planned annual addition of 75 properties per year by 2005. US Franchise Systems also owns Hawthorn Suites, for which it expects to open another 22 properties by year-end. Wingate Inns International and AmeriHost Franchise Systems have opened five Wingate hotels to-date in 2002, with another 19 expected by the end of the year, well within their goal to open 20-25 Wingate properties per year. Carlson's Country Inn & Suites development program is currently tracking approximately 17 percent below 2001 levels, with 15 hotels opening to-date in 2002 and another 36 to 40 properties expected by year end 2002.

Asia Pacific – Popularity Continues to Build

Perhaps more than any other region in the Asia Pacific, Australia has enjoyed the largest boost in popularity and indeed investment in serviced apartments. Serviced apartments are the fastest growing form of tourist accommodation in Australia, both in terms of supply and demand. Traditionally serviced apartments in Australia have appealed mainly to the longer stay guests, however, over the recent past there has been a dramatic shift towards short stay guests, which in some cases comprise 60% of revenue for serviced apartment complexes. This style of accommodation is particularly popular with business and inter-state travellers who prefer the low-cost and personalised space of these 'residential dwellings' rather than more expensive hotel rooms.

In line with US trends, the serviced apartment sector is outperforming the general market. Demand rose 9.3 percent in Q1-02, compared with hotels recording a static rate. Revenues in turn have shown healthy growth for the serviced apartment sector. This has been driven by the cost competitiveness of this sector as corporates downsize travel budgets and more cost conscious leisure market grows. In addition, the serviced apartment sector has more new product, which is appealing to both corporate and leisure travellers.

Currently, it is estimated Australia has 668 serviced apartment complexes with over 35,000 units, which represents a 2.6% increase over the previous year. Developers have embraced the serviced apartment concept, which features prominently in projects under construction. In fact serviced apartments currently constitute 69.4% of all commercial accommodation projects under construction in the major markets of Australia. The popularity of serviced apartments is also evidenced by the aggressive growth of one of Australia's largest serviced apartment groups Quest, which plans to almost double in size over the next five years to capitalise on an expected surge in international corporate business.

Australian serviced apartment revenues outperform hotels in 2002.

In addition to the promising demand expectations, the key factors driving the continued increases in serviced apartment stock are the low discount to replacement cost and availability of funding. Serviced apartments appeal to a wider range of investors and are able to tap into the "mum and dad" investor as they do not require substantial funds given they can be sold on a per-unit basis under a strata-title structure. These investors are willing to accept a lower investment yield due to the lifestyle and capital growth benefits.

Europe – A Different Point in the Cycle

Until recently there have been few alternatives to hotels for business or leisure travellers seeking longer-term accommodation throughout Europe. While serviced apartments are well established in the US and Asia Pacific, the European sector is at an earlier stage, due to a different demand profile. Within Europe business travel tends to take place over much shorter periods. The relative proximity of different business communities and the introduction of the hugely successful budget airlines means that these distances are almost "commutable". This combined with the lower levels of job mobility in Europe negates, to a degree, the need for long-stay accommodation.

The current supply is dominated by higher-end accommodation, with corporates providing the core area of demand. However, experience in other countries (particularly on the Continent) suggests that the scale and profile of the market may be considerably broader. In addition greater international leisure travel and an increasing trend towards taking extended breaks between jobs, sabbaticals and working-holidays are also impacting the demand for temporary accommodation.

As a function of the differing demand profile in the European serviced apartment sector, the market is fragmented and lacks the consistency of quality found in more developed markets overseas. In the UK, apartments often form a component of a hotel, whereby tenants are able to use the hotel facilities. Again these differ by type of location, those in the resort locations where package tours dominate are predominately individually owned and operated. For example, in the Spanish coastal resort regions the majority of accommodation takes the form of serviced apartments, generally large holiday complexes offering tourist class services. The majority of these holiday resort complexes are privately owned and operated, however there is an increasing amount of investment being seen by Spanish hotel chains and also European tour operators.

There is definite evidence the serviced apartment sector is developing, manifested by new construction and the emergence of international brands throughout many European cities. Regional operators, particularly in the UK, France and Germany have pursued development plans, with major brands including Citadines, Maeva, Pierre et Vacances and Cheval Apartments. In addition, over the last four years there has been an increase in interest amongst international serviced apartment operators in response to the perceived growth in demand primarily resulting from changing business travel patterns. International operators are starting to push into European markets, to capitalise on the growing demand and limited supply of this

Serviced apartment supply in Europe is growing, led by international operators.

accommodation type. The entry point tends to be UK and in most instances the operators have entered the market through either acquisition of a UK operation or have entered a joint venture arrangement with a UK operator or developer, for example MeriStar's Bridge Street brand. More recently, Dublin based Prem Group signed an exclusive European-wide franchise agreement with Cendant Corporation for their Howard Johnson serviced apartment brand.

In addition, Marriott has launched their Execustay brand in Europe with their Executive Apartments in Belgium, Budapest and Prague. Accor is also developing its Suitehotel concept. The Ascott Group (owned by CapitaLand) is currently undergoing a major re-branding campaign in the UK, repositioning 680 apartments to tap further opportunities in the UK and to springboard into other European cities such as Paris, Frankfurt, Brussels and Milan. They believe there is scope to more than double the serviced apartment stock in the UK to bring it in line with US ratios where serviced apartments occupy close to five percent of the total room supply.

Eastern European markets are also beginning to warm to the serviced apartment concept, with demand increasing. For example, international brands such as Marriott, Inter-Continental and regional operators such as Orco now have a serviced apartment presence in Prague.

The recent performance of the serviced apartment sector has been mixed, with leisure-based properties, such as those in Spain, performing above their city-centre counterparts. Corporate-based properties in city centers such as London have been impacted by the decline in travel, particularly those brands exposed to US corporate demand. Serviced apartments rents across the UK fell by around five percent in 2001, although this decline has softened more recently to around three percent in Q1-02. However, this has prompted a restructuring of lease agreements. For example, Bridge Street, has extracted itself from a number of traditional five-year leases and is looking to secure US-style contract leases, where operators pay rent only while there is a tenant in the apartment. But the rent passed on to the landlord is around a third higher than under traditional leases with serviced apartment operators. This has given them more flexibility to adjust their inventory in response to changing demand conditions. A number of other high profile operators are exploring such restructures, which are likely to become more common as international players increase their presence in the local market.

Leisure - based apartments in Europe out - perform city counterparts

Conclusion

While amenities may differ, the serviced apartment segment has proven that it can weather large scale economic downturns and has emerged as a viable investment vehicle within the global hospitality market. While further product will continue to come on line in the Americas and Asia Pacific, Europe is comparatively the most unchartered territory. Now that international operators have begun a push for market presence in Europe, a dramatic increase in the amount of serviced apartments catering to the business traveller is expected over the next few years.

The Major Players

Who is investing in serviced apartments and where? Can anyone succeed in this business or does success depend on a specialist knowledge and understanding of the dynamics of serviced apartment operation?

By Camille Savory, Research Analyst, London
Graham Craggs, Executive Vice President, London
David Bridge, Executive Vice President, London

The serviced apartment market has yet to reach the heights of the full-service sector, although this type of accommodation is becoming increasingly popular in the US and Asia Pacific. Evidence in these markets points to the most successful players in the serviced apartment market being those who offer a recognisably branded product.

This article examines the major players in the global serviced apartment market, benchmarking regional differences of owner and operator structure. In additional the advantages and disadvantages of hotel operators vs serviced apartment operators are detailed.

Ownership Structure

Owner Operators

In direct contrast to the US, Asia and Australia, the short stay serviced apartments market in Europe is dominated by largely unbranded owner-operators, typically private families or investors.

In Australia, although the management of serviced apartments is undertaken by specialist operators, the majority of the real estate is owned by individual private investors. This individual ownership is a popular method of financing a development by pre-selling units to individual retail investors, thus reducing the risks associated with a traditional hotel-financing model. The investors are attracted by the 'quasi' residential nature with the proviso that it is purchased with a guaranteed short term income stream by the developer. Many buyers are attracted to the lifestyle benefits of ownership, personal income tax reductions and the high returns compared to traditional residential investments.

High level of individual ownership in Europe and Australia

Hotel Companies

Driven by anticipated higher occupancy levels and guest demand patterns, a number of traditional hotel operators have branched out into the serviced apartment market. This type of product is typically targeted at the long-staying corporate guests, rather than leisure demand.

Hotel companies are most prevalent in the relatively mature US market where they offer guests an array of brands. For example Marriott's "Residence Inn" brand, Hilton's "Embassy Suites" and "Homewood Suites" as well as Six Continents' "Staybridge Suites". These brands are independent of the full-service brands and have a higher tendency towards franchising. Indeed many of these brands were originally established by developers, and then sold on to hotel companies, such as Marriott's "Residence Inn" brand. This type of structure is rare in Asia Pacific and the less mature markets of Europe.

In Europe, recognised operators, such as Hilton, Marriott and Accor have a small presence within the market place. They offer similar levels of amenities and products in their serviced apartments to their hotels. The operators' brand is prominent eg 'Marriott Executive Apartments', and may share marketing or operational systems with their sister hotels. There is much debate as to whether this is the most effective strategy to obtain market penetration.

In addition some existing traditional hotels in Europe and Asia have added a wing of serviced apartments attached to the main hotel, where guests have to access to all the hotel facilities. This type of operation targets long-staying corporate guests or high-spending visitors/tourists and is most prevalent in major cities such as London and Paris.

Serviced Apartment Operators

The majority of specialist serviced apartment operators in the US, such as Extended Stay America and Sierra Suites, own the real estate as well as operating the business. Operators such as Bridge Street and Oakwood who are US-based but also active in the UK, are the 'serviced office' providers of the accommodation world, enjoying extreme supply flexibility due to short term leases. They lease space from landlords, often on an individual apartment level, which are then leased to corporate clients.

There are a number of well established serviced apartment operators in Asia Pacific, particularly Australia. These operators typically control the management of the serviced apartments, with ownership of the real estate remaining with individual owners. These operators tend to sell down the real estate to reduce risk and fund further expansion plans and include Mirvac, Pacific International, Quest, Oakford and Saville (part of The Stockland Group).

In Europe there are also pure serviced apartment operators in existence. They are most active in the more mature French market, the largest being Pierre et Vacances and Citadines. Both began their serviced apartment lives in the resort markets, but have now shifted their emphasis to city centres and the corporate markets.

These operators have been successful in developing their own properties and then attracting institutional investors to finance entire projects, akin to sale and leaseback structures in the hotel market. Pierre et Vacances have a fairly varied portfolio; also selling individual apartments which are similar to a 'time-share' offering, aimed at both the leisure and corporate markets.

Developers

Dominant in the US, Asia, and Australia are long stay (quasi residential) serviced apartments. Higher levels of expatriate business people, and geographic distances between major markets often require longer lengths of stay, and drive a different type of demand profile.

Common in Asia and Australia, are property developers (often residential) who have formulated their own specific serviced apartment brand. Medina and The Stockland Group in Australia own and operate own–branded serviced apartments, under separate operating divisions.

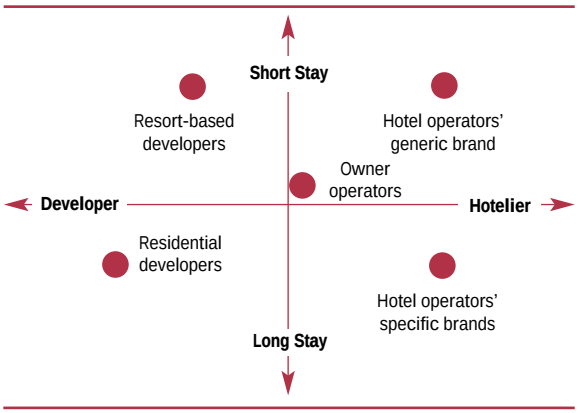
In 2001, the established Asian developer and serviced apartment operator, the Ascott group, linked up with the UK based developer Crown Dilmun, in a joint venture company 'Ascott Dilmun'. The UK properties of the two are being sold to the new company and operated under the 'Central Apartments' brand, which aims to leverage its combined expertise to fuel rapid expansion throughout Europe.

There are also developers, either self-funded or backed by institutions, who create serviced apartment complexes, and then let them to specialist serviced apartment operators on varying leases. This is a similar situation to that which exists in the office market.

The 'father' of the US serviced apartment markets is generally regarded as being Jack DeBoer, a residential developer who launched the Residence Inn brand, and has also been instrumental in developing Candlewood Suites, Summerfield Suites and Cambridge Suites.

Current activity

The specialist US serviced apartment operators are now looking to expand into Europe, initially London, led by Bridge Street and Oakwood. Bridge Street operates or has marketing agreements with 26 London properties and representation in ten European cities, particularly Paris. Oakwood has serviced apartment complexes in four areas of London, as well as other locations in the UK, and is currently represented in seven



European countries.

From the development end of the spectrum, the Ascott group, having established themselves firmly in Asia, also aims to establish a presence in the UK. Their November 2001 joint venture with UK developer Crown Dilmun, Central Apartments, now has improved access to funding, local market knowledge and operational expertise to enable rapid expansion. The joint venture has cited cities such as Paris, Frankfurt, Brussels and Milan as expansion targets.

In addition to the UK, the Ascott group have also established a presence in Australia via their acquisition of Oakford in October 2001 for US$4 million. This includes the management contracts and leases of nine operational serviced residences with 466 units.

In the more advanced French market, there has been merger and acquisition activity in the past few years as the main players rationalised their market offering, and divested themselves of extraneous parts of their portfolio. For example, in 1997, Westmont bought both the Citadines and Orion brands. In 1999 Maeva merged with the largely resort-based Vacantel, and in 2001 Pierre et Vacances in turn acquired Maeva, giving it a strong presence in both the resort and city centre markets.

Developers have a natural affinity with the serviced apartment products

More recently in the USA Apple Hospitality (a REIT) bought a portfolio of 23 extended stay hotels operated under the Marriott Residence Inn brand for US$160 million. The deal which took place in September 2002 was financed by Nomura.

The Advantages for Developers

The specialist knowledge of residential developers indicates developers may have a natural affinity for this type of product, particularly in markets where the serviced apartment offering is in its infancy. Residential developers, provided they brand appropriately, are able to find synergies with their accommodation provision. Achievable monthly rents for serviced apartments are higher than residential apartments, while occupancy stability is not greatly compromised, particularly with longer lets. In addition, the location of retail

Operator	Region	Origin	Own	Lease	Manage
Ascott (Oakford)	Asia, Australia	Residential developer	yes	in Australia	in Japan
Ascott – Dilmun	UK	Residential developer	develop then sell	no	yes
Bridge Street	US	Serviced apartment operator	no	no	yes
Citadines	France , UK	Resort developer	develop	yes	yes
City Developments	Singapore	Real estate developer	yes	no	no
Cheval	France, UK	Private family (hoteliers)	yes	no	no
Derag	Germany	Developer	yes	no	yes
Embassy Suites, Homewood Suites (Hilton Hotels Corp)	US	Hotel operator	yes	no	yes
Far East Organisation	Singapore	Real estate developer	yes	no	no
Fraser Suites	Asia	Developer	yes	no	yes
Medina	Australia	Developer	yes	yes	yes
Mirvac	Australia	Developer	no	no	yes
Oakwood	US, UK, Asia	Private	no	no	yes
Pacific International	Australia	Private	no	yes	yes
Pierre et Vacances	France	Resort developer	yes	no	yes
Quest	Australia	Private	no	yes	no
Residence Inns (Marriott)	US	Residential developer	yes	yes	yes
Saville Group	Australia	Commercial/ residential developer	no	yes	yes
Staybridge Suites (Six Continents)	US	Hotel operator	yes	no	yes

Source: Jones Lang LaSalle Hotels

or independent restaurant outlets on the ground floor, simultaneously providing guest services and further income streams, again often dovetail with developers' area of expertise.

Residential and office buildings have been successfully converted to serviced apartments, particularly in Europe where land availability is generally less, and suitable site locations harder to find. In addition serviced apartments do not require the 'high street presence' of hotels.

Similarly, carefully constructed, serviced apartment complexes have the ability to modify the original product configuration, and, if rates of return warrant, be converted to standard residential accommodation as an exit strategy. This has been the case in the Sydney market which saw a flurry of serviced apartment construction in the lead-up to the Olympic Games, and due to over-supply in the aftermath have been successfully converted to residential use.

The Advantages for Hoteliers

One of the often-cited attractions of serviced apartments, is the stability of income stream. Compared to traditional hotels, serviced apartments are potentially attractive to long-term investors, providing more stable returns even under management-style contract arrangements. Thus hotel operators with a combination of room and apartment product offering may attract greater interest from institutional investors.

However, it is generally impractical for hotel owners wishing to enter the serviced apartment market to convert their hotel product. Existing facilities prevent typical economies enjoyed by serviced apartments, and hotel room sizes are often too small to meet requirements. Some US operators argue that conversion is possible (one apartment for every two hotel rooms), but concede the resulting product is less attractive due to its age. Even franchise brands prefer new-build products.

Indeed, it is suggested that the hotels with existing serviced apartment wings should convert them to bedrooms, as they are not using available facilities to full advantage.

'Amenity creep' is a potential danger for hoteliers planning new-build serviced apartments, eroding traditional cost advantages. Importantly, hoteliers need to bear in mind that unless longer stay demand is targeted, planning regulations remain the same as for a hotel, and will not provide any advantages in accessing locations where competition for space is fierce. The strength and associations of hotel brands may provide an advantage in the shorter stay, leisure focussed serviced apartment market, but may not be as valuable a stepping stone into the longer stay, corporate housing market. However, that said, some of the major French operators have managed a successful transition, from their beginnings as resort operators to a focus on the city centre market.

Conversion from hotels often impratical

Operators acting as 'middlemen' between developers / owners and corporate clients, for the provision of longer-term serviced accommodation, are more corporate housing providers than realtors or hoteliers. Thus, companies such as Accor, who already provide various corporate services, could have an advantage in entering this market.

The Future

Having established themselves in a clear market niche in Asia Pacific and the US, the serviced apartment markets are driven by specialist players. However, in Europe, the market, in terms of offering and players, remains fragmented. Various local and international operators have entered the market, but have not as yet established a strong presence, except in France. Indeed the advantages for entering the serviced apartment market tend to be higher for developers rather than hotel companies.

VALUATION ISSUES - Serviced Apartments Versus Hotels

What are the drivers of value in serviced apartment assets? Do the higher occupancy levels translate into increased value?

By Anthony Corbett, Vice President, Sydney

It is generally accepted within the accommodation industry that serviced apartments typically trade at higher occupancies compared to equivalent standard full-service hotels. So, is it correct to assume this translates into higher capital values for serviced apartments? Not necessarily! This article explores the factors that affect profitability and therefore the value of serviced apartments compared to hotels.

Serviced apartment occupancy levels higher than hotels.

From the perspective of a buyer or seller, the methods of assessing value of serviced apartments held in-one-line as 'going concerns' are essentially the same as those used to appraise hotel assets. An assessment of value of serviced apartments must encompass:

- Understanding the dynamics of the serviced apartment market as well as its interaction with the broader hotel market;
- Review of the physical attributes of the property and its location;
- Review of the business profile;
- Impact of management/branding;
- Financial analysis of the business; and
- Investment analysis

In addition to the terms listed above, there are a number of factors unique to serviced apartments that should be considered. We will discuss these separately and their impact on value.

Accommodation Revenue Performance

The most apparent differences with serviced apartments are their normally higher occupancy and composition of income stream compared to hotels.

In terms of occupancy, serviced apartments are not usually exposed to the decrease in demand for accommodation on weekends experienced by many hotels in commercial locations because of a greater average length of stay. In some markets they can also supplement weekly occupancy with leisure business depending on the location. The design and configuration of apartments enable flexibility of use for both extended-stay and shorter-stay demand, therefore enhancing revenue.

While serviced apartments are on average significantly larger than conventional hotel rooms, they generally offer a discounted rate (relative to the accommodation size) in order to attract longer stay business and to compensate for a lower level of service and facilities compared to a hotel. Broadly, we would usually expect the room rate achieved by serviced apartments to be on par with a similar full-service hotel despite the difference in accommodation area.

On this basis revpar (revenue per available room) is generally higher for serviced apartments compared to a full-service hotel driven by more robust occupancy performance of serviced apartments. However because they provide larger accommodation area compared to a conventional hotel room, serviced apartments' revpar on an area basis is actually lower. We note these comparisons are somewhat problematic in respect of the unique attributes of each property, the assumptions regarding branding and management and that they typically service different markets each subject to their own dynamics and conditions at a particular a point in time.

Serviced apartment revpar higher than hotels, although lower on an area basis.

Food and Beverage

Non-accommodation revenue in serviced apartments is growing as a proportion of total revenues as an increasing number of operators offer a wider variety of services such as small meeting and conference room hire, catering, equipment hire, carparking, charge-back of food and beverage to rooms, dry cleaning, pay per view video, business services and others. However, typically this does not include any substantial revenues from food and beverage as outlets are often either leased, contracted out to a third party or not provided. The absence of this lower margin and labour intensive business obviously has positive effect on overall profitability ratios.

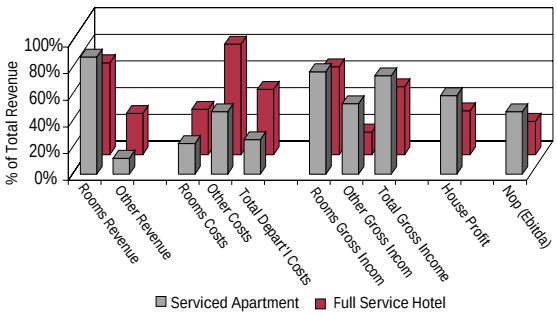
Lower Operating Costs

Major differences exist in the cost of operating serviced apartments versus full-service hotels. Significantly lower payroll costs are normally incurred when operating serviced apartments compared to hotels as guests trade increased accommodation space for less intensive levels of service. Generally the longer the stay the lower the room servicing costs, with some properties only servicing rooms on request or at check out time. As no direct food and beverage service or outlets are provided, payroll costs are significantly lower

than a hotel flowing through to superior profitability ratios.

Staffing is often more efficient with self-management, flexible multi tasking and teamwork practices. Lower turnover of rooms and a high proportion of business traveller guests may provide less guest room "wear and tear" compared to a hotel that has shorter length of stay and more reliance on higher turn-over and group markets. Lower property operations and maintenance costs may also be expected in this instance.

Indicative Revenue and Profitability Comparison



Source: Jones Lang LaSalle Hotels and is indicative only for the purposes of comparison of a hypothetical serviced apartment operation with a full-service hotel in major international city location.

Location

The location of a successful serviced apartment operation need not be in as prime or central position as that required by a hotel. Serviced apartments are able to operate in secondary retail or hotel locations because they also have convenient residential style attributes that both encourage and appeal to a long-stay guest who is usually prepared to trade a prime location for expanded accommodation area.

Notwithstanding the above, the business mix is weighted to corporates hence proximity to business parks, central business district and other commercial centres are preferable to others.

Lower Barriers to Entry

In some markets existing residential developments are relatively easily converted to serviced apartments. Therefore barriers to entry compared to hotels are lower and should be considered when assessing future additions to competitive supply. This also has implications for the wider accommodation market depending on the extent that extended stay product competes with hotels in a particular location. This is most prevalent, for example in holiday locations where residential apartments have the potential to become tourist accommodation, for example the Gold Coast in Australia or Costa del Sol in Spain.

The factors above may be somewhat offset by local market land use regulations that can restrict length of stay in serviced apartments. As examples, in London serviced apartments in residential areas cannot be occupied for less than 90 days while in Tokyo serviced apartments are restricted to a minimum stay of one week (in any land use zone). In contrast most Australian cities have no minimum stay regulations for serviced apartments, rather are more likely to restrict maximum occupancy to 3 months to prevent them from being used for purely residential purposes in conflict with their original development consent. Consequently they tend to compete more directly with traditional shorter stay hotels and are somewhat more resilient to downturns in demand as they can target both short and long stay markets simultaneously. This arguably has detrimental affect on performance of the wider hotel market, especially in times of weak corporate demand.

Conversion from residential development results in lower barriers to entry.

Another issue raised by US investors and financiers is that while these extended-stay properties are real estate based on hotel zoning, the quasi residential nature of the product means that investments may be subject to dispossessory laws which could potentially affect the ongoing operation of the extended-stay hotel (i.e. even without a lease, landlord-tenant law applies including onerous eviction laws).

Demand Base

Another consideration is to determine the particular market the property services. Is it longer stay (i.e. 3 days or more) or longer term (i.e. a month or more)? For example is the property servicing all or some of the domestic and international business traveller markets, relocating executives, female business travellers, families and small meetings? The type of market that the property is servicing has a bearing on quantifying the competitive supply and hence risk. An average length of stay at three days or more may indicate that the property is competing (at least in some segments) with traditional short stay hotel product while longer stay business may well be competing with the local residential apartments (especially in a strong market).

In some markets, and particularly in the US, the development of extended-stay product is so mature that there are now many brand segments which can lead to guest confusion about the level of service and guest amenity provided. In these instances, the importance of brand recognition is highlighted.

Development Costs

Construction costs of a serviced apartment are significantly lower than a similar quality full-service transient hotel product as they are free of costs associated with providing large public areas and food and beverage outlets. For example in the US, typically they are mid-rise, of timber frame construction similar in quality to economy hotels.

Construction costs of serviced apartments lower than hotels.

While land acquisition costs can be considerably higher per apartment (or key basis) compared to full-service hotels, the price of land on a rate per unit of area (i.e. after adjusting for the larger size of serviced apartments) is more comparable to hotels.

Sales evidence available indicates they trade at similar multiples of profit as full-service hotels. Generally, this indicates the investment market perceives that extended-stay hotels are a relatively lower risk investment.

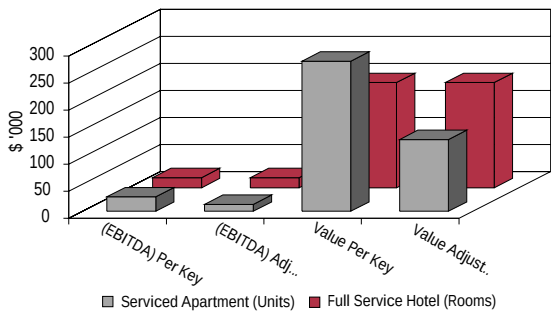
In some markets, the potential for investors to convert their serviced apartments into residential apartments (to be sold individually on the retail market) is available somewhat off-setting the operational risk because of a high underlying alternate use value. This helps refinancing risk and is favourably viewed by lenders.

Indicative Profit and Value Comparison

How do the above considerations relate to value? Keeping in mind the limitations in comparing serviced apartments and full-service hotels mentioned earlier, our analysis shows EBITDA and value to be higher on a per serviced apartment basis (or per key) than that of a full-service hotel. However after adjusting for the large size of serviced apartments they can in fact represent a lower EBITDA and value on an area of lodging basis.

Further analysis indicates that after factoring in additional public areas and building space utilised for food and beverage facilities in full-service hotels compared to serviced apartments, we expect the (EBITDA) and value for both types of property on a total building area basis to be similar overall.

Indicative Value Comparison of Serviced Apartment Versus Full Service Hotel



Source: Jones Lang LaSalle Hotels.
NB: This is indicative only.

	Serviced Apartment (Compared to a similar full-service hotel)	Affect on Value
Occupancy	Higher	↑
Average Daily Rate	Same	—
RevPar (per key)	Higher	↑
RevPar (over lodging area)	Lower	↓
Accomm. Revenue ($)	Lower	↓
Accomm. Revenue (per key)	Higher	↑
Non-accomm. Revenue ($)	Lower	↓
Non-accomm. Revenue (per key)	Lower	↓
Total Revenue ($)	Lower	↓
Total Revenue (per key)	Lower	↓
Depart'l Costs & Expenses ($)	Lower	↓
Depart'l Costs & Expenses (per key)	Lower	↓
Gross Income ($)	Lower	↓
Gross Income (per key)	Higher	↑
Undist'd Operating Expenses ($)	Lower	↓
Undist'd Operating Expenses (per key)	Marginally Lower	↓
House Profit ($)	Lower	↓
House Profit (per key)	Higher	↑
Overhead Expenses ($)	Lower	↓
Overhead Expenses (per key)	Marginally Higher	↑
(EBITDA) ($)	Lower	↓
(EBITDA) per key	Higher	↑
(EBITDA) over lodging area	Lower	↓
(EBITDA) over total building area	Similar	—

Source: Jones Lang LaSalle Hotels.

An Investor Checklist

What should investors look for when assessing a serviced apartment opportunity? What are the minefields that should be avoided and the opportunities to seek out? David Ling in Singapore and Mark Durran in Sydney analyse the key investment issues.

Every serviced apartment property is unique in terms of its location, accommodation, facilities, ownership and / or management. When reviewing a serviced apartment investment, it is important to fully investigate on a case-by-case basis the characteristics of a particular property, the competitive market and investment risk and return profile.

Demand profiles and customer requirements for serviced apartments can vary dramatically from country to country and region to region. The following table seeks to highlight some of the key issues or considerations an investor should pay attention to when assessing an opportunity.

	Issues	Comments
Market Demand	• Establish demand profile for serviced apartments • Presence of multi-national corporations (MNC) / foreign direct investments particularly in Asia. • Affordability (general policy and budget for expatriate housing) • Prospect for growth in demand of serviced apartment accommodation	Generally, there is steady demand for serviced apartment properties in cities where there is a large base of multi-national corporations such as in London, New York, Paris, Hong Kong, Singapore and Sydney. Each market is characterised by differing demand profiles eg corporate vs leisure, but even more specifically a market dominated by travelling middle managers from manufacturing based MNCs, vs senior executives from the capital markets.
Market Supply	• Competitive supply, type and quality of apartment and services • Future supply profile and barriers to entry • Supply of both conventional hotel rooms and residential apartments	Conventional hotel rooms and private rental apartments may compete with serviced apartments. Hence, it is important to monitor supply trends of all the three accommodation sectors – hotel, serviced apartment and private residential apartment lettings. For example, an over supply of residential investment units can potentially impact serviced apartments returns as residential investor unit owners target the fully furnished (usually extended stay) executive letting market.
Operational Performance	• Apartment rental rates and occupancy rates • Other revenue sources (e.g. food and beverage sales, spa facility) • Operating cost and expenses • Non-operating cost, expenses and other overheads • Profit margin	Profit margins as a percentage of total revenue from serviced apartments are commonly higher than for hotel properties due to the lower operational costs particularly in payroll. However, measured in currency values, serviced apartment on per available key basis may not necessary generate higher value due to the fact that major hotels often have other significant revenue sources such as food and beverage operations, function facilities and spas.
Location	• Convenient access to offices / central business district • Convenient access to tourist attractions (especially in the case of resort based serviced apartments) and entertainment or sporting venues. • Close to major transportation routes • Close to amenities (shopping, food and entertainment) • Ambience (privacy and general environment)	A key segment for city based serviced apartments is the business traveller. Therefore serviced apartments located near to corporate offices, business parks as well as transport services have key selling advantages. Close proximity to restaurants and cafes is important as many serviced apartment operations do not offer F&B facilities in house.
Investment Returns	• Initial yield • Cash flow analysis • Internal Rate of Return (IRR) • Payback period • Debt coverage	There are various tools for measuring returns from real estate investments, including the initial yield (widely used in the UK and Asia for established commercial properties) and cash flow analysis and IRR (commonly applied in North America, Australia and increasingly in Asia).
Exit Strategy	• Direct property sale • Strata-subdivide and sell individual apartments to investors or residential owner occupiers. • Sale of partial interest / joint ventures • Property trusts • Change of use to residential or redevelopment.	As real estate is a relatively illiquid commodity, one of the most serious challenges is the ability to exit as and when required. One of the main reasons for the proliferation of serviced apartments development over the past decade is due to the flexibility (and added profits) in most countries for an investor/developer to strata sub-divide and sell down units to individual investors or residential owner occupiers (if zoning/approvals allow) depending on prevailing market conditions. This provides investors in serviced apartments with more diverse exit options for their investment than traditional hotel owners.

Management	• Terms and conditions of the management agreement (management and other fee structures, operating period, renewal option, budget control, reporting structure, ability to terminate without cause or upon sale, etc.) • Operator track record and marketing capability • Can vacant possession of existing management contract be obtained or have these management rights been sold to another party? • Who owns common area, front desk, restaurant, function facilities and therefore effectively controls the operation? • Who controls the body corporate? • Who is responsible for FFE/capital renewal reserves? • If the property is leased to an operator (term of lease, quality of covenant or security backing the lease eg bank guarantee, security bond or corporate guarantee, rent (fixed or % of turnover). What is the mechanism for retail growth?	A reputable operator with a wide marketing reach to multi-national corporate businesses is an advantage. Apart from management fees, it is important for prospective investors to carefully assess the other terms and conditions of a management or lease agreement. These include the type of services provided, cost implications, level of control over key decisions affecting the property such as budgeting, major expenditures and appointment of key staff, as well as the impact on the saleability and potential market value of the property. A property that is encumbered by a long-term agreement or lease without provision for early termination or buy back of 'the management rights' tends to have much less market appeal compared to one available with vacant possession where the purchaser is free to decide which operator should manage the property or ability to strata subdivide and sell the apartments when market conditions are conducive. The issue of who pays for refurbishment and when it is timed is crucial especially in a leased property.
Town Planning and Licensing	• Current land use zoning and or approved use (for example tourism or residential) • Licensing requirements for serviced apartments • Control over strata sub-division of serviced apartments	In some countries, there is a minimum stay requirement for serviced apartments such as in London and Singapore, while there is little regulatory control in other countries (e.g. France). A property that is zoned for residential use reduces investment risk and provides an alternative income stream and future alternative exit strategy. In some countries, serviced apartments maybe subdivided and sold to individual strata owners, for example in Australia. In other countries a strata sell down to individual owners may not be allowed without a change of use approval to residential.
Country Risk	• Inflation and currency exchange rate fluctuations • Control over repatriation of profit and foreign exchange • Withholding tax, capital gains tax and other taxes • Labour laws and union policies • Transparency over business practices, laws and regulations	Investors are exposed to various other risks especially when venturing into a foreign country. These factors such as political stability, social and economic environment will influence the success of a serviced apartment investment and its return.
Facilities	• Food and beverage – café, restaurant or bar or none • Recreation – gym, swimming pool, sauna, spa, etc. • Car parking facility • Business facilities	Premium serviced apartment properties provide a wide range of facilities such as those available at a major hotel. These full serviced properties compete with hotels for short term guests. Those offering limited facilities are usually targeted at extended stay markets. Data points in rooms, large work desk, natural lighting, full air-conditioning, balcony and good security for guests are also important 'hot buttons'.
Economic Life	• Age and condition of the property • Economic viability of the serviced apartments • Prospect for refurbishment or repositioning	There are properties that have gone past their economic relevance and are in need of refurbishment in order to compete effectively in the marketplace. Repositioning or change of use may also be viable options. Investors should ensure thorough due diligence is undertaken.
Level of Services	• Housekeeping services • Room service orders • Transportation and travel services • Child care services	The level of service varies from one property to another. There are those that provide a full range of services such as daily housekeeping, laundry and room service orders, whilst others provided a limited type of services. Whilst there may be opportunity to generate additional revenue through a wider range of services, payroll and operating costs are likely to be higher to maintain such services.
Real Estate Ownership and Transfer	• Freehold or fee simple • Leasehold • Land use rights • Private leases • Transferability of real estate interests	Whilst most serviced apartments in North America, Australia and the UK are under freehold or fee simple ownership, there are many properties in Asia that are held as leasehold interest or land use rights with differing tenure, rights and obligations attached. Most countries have some form of restrictions or control over ownership of certain types of real estate interest by a foreign entity.
Financing	• Equity raising / participation • Sources of debt finance • Costs of capital • Currency denomination	Whilst it is relatively easy to secure debt financing for real estate acquisitions in North America, Europe and Australia, real estate financing is not readily available for acquisitions in some parts of Asia.

Biographies

David Bridge
Executive Vice President

David has over 20 years experience in the hotel sector and is a qualified chartered accountant. He currently has responsibility for asset management across Europe and has expertise in management contract and lease negotiation, hotel financing, due diligence, financial and operational supervision of clients' assets as well as development supervision.

Anthony Corbett
Vice President

Anthony is in the Corporate Advisory team, based in Sydney, Australia with responsibility for a wide range of hotel and tourism advisory assignments in the Asia Pacific Region. Anthony is consulted by major hotel owners, operators, institutions and financial intermediaries. He has over 12 years experience in the property industry across all asset classes.

Graham Craggs
Executive Vice President

Graham is responsible for the daily management of the valuation and advisory team of Jones Lang LaSalle Hotels within Europe. He is also responsible for providing valuation and real estate advice in connection with operational hotels, direct investments in the sector and hotel related development opportunities. Graham has experience of a wide range of markets throughout Europe.

Mark Durran
Senior Vice President

Mark Durran has 15 years experience in the hotel and property industry and diverse expertise in hotel operations and marketing, development and hotel transactions. He is currently responsible for major hotel property transactions in Australia and consulting on operator agreements for hotel owners and developers.

David Ling
Senior Vice President

David is currently responsible for the investment sales of hotels, resorts and serviced apartment properties located in Asia to institutional and private investors. He has almost 10 years experience in the hotel and property sectors. David also has extensive experience in providing advisory services including valuations, hotel operational reviews, hotel demand studies and cash flow projections to clients.

Melinda McKay
Senior Vice President

Melinda is responsible for strategic investment research for Jones Lang LaSalle Hotels, along with the marketing and tactical execution of global research for Jones Lang LaSalle. She has over a decade of experience in the hotel industry and has published a number of reports, being widely quoted in the US and international press.

Camille Savory
Research Analyst

Camille is responsible for providing market intelligence and research support for the European team, as well as external clients. She produces one of the leading research publications in the European market, the Digest Europe, a report on 23 of Europe's major hotel markets.

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