

ALTERNATY PROPERTY DEVELOPMENT SCENARIO SERIES:

ISSUE #1

Hotel versus Serviced Apartments

With the steady growth of business travel and changing accommodation trends, serviced apartments are becoming an appealing alternative to other forms of lodging property investment. There are substantial differences from typical hotels but there are also several similarities. We have illustrated in this paper what developers should consider when making decisions about the development of hotel and serviced apartments.

HOW DO SERVICED APARTMENTS DIFFER FROM HOTELS?

Hotels have a clear business designation. There are different ways to classify hotel types, such as by target customer (business or leisure oriented guest), by positioning (economy to luxury) or by level of services (limited service to full service). However, they all have a clear designation in term of guest's length of stay: **"short-term"**.

With the exception of the extended stay model, the majority of the hotels are well equipped for accommodating shorter term stay, one or a few nights, with less focus on the need of visitors planning to stay for an extended timeframe. Serviced Apartments, in their basic form, provide an option for lodging guests requiring a home-like environment, with the aim of increasing comfort for longer term visitors.

SERVICED APARTMENT DESIGN FEATURES

- Larger Rooms – typically from 32 sm to 45 sm for Midscale brands or Aparthotel and more than 55 sm for Upscale brands.

- Cooking Area – Serviced Apartments typically require a fully equipped kitchen or at minimum a kitchenette corner.

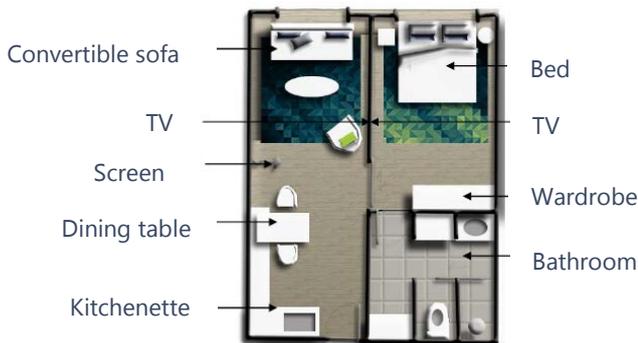
- Reduced Front of House – the reception is typically much smaller compared to a Hotel with scaled down lobby area and luggage space.

- Reduced F&B space – in the Midscale segment of Serviced Apartment, food offerings are usually limited to breakfast. In certain cases, the F&B offerings can be turned into a "grab & go" concept and integrated in the multi-function reception area. Outsourcing F&B could also be a preferred option.

- Reduced facilities – some offerings such as spa, meeting space and executive lounges are typically not necessary in Serviced Apartments. A swimming pool could be offered and a gym remains a must.

- Social space – it is important to create social space for guests to interact and socialize. More frequently in Upscale properties, a library, pool area or gaming area is often added as part of the social space. Kids club is also a good inclusion for families. Developers need to cater for the needs of the new business traveler type as they often socialize as well as engage with local community during the business trip.

- Guest-use public areas – this is where it gets interesting. Particularly in the Midscale category, in order to reduce the operating costs but still offer full comfort to the guests, developers often provide automated services. Laundry area, for instance, with laundromat and ironing boards, allows guests to do their own laundry at lower costs. Vending machines are also often used to offer F&B choices 24/7 when a reliable service provider is available.



* Shama Hub (Midscale Brand) – Typical Unit Plan 32 sm – 48 sm – 64 sm
Authorized for use by ONYX Hospitality Group.



Shama serviced apartments, Bangkok

WHO IS THE NEW TYPE OF CLIENT?

Historically, the serviced apartment concept was developed to cater to corporate travelers who require comfortable space during short to medium term assignments, as well as to those in the process of relocating and requiring interim accommodation. However, over the past few years, in the search for higher yield, the serviced apartment business has been innovated, with the effort to revise the traditional long term model to be able to capture not only medium to long term guest but also short term transient guests. With the expansion of “home stay” concept, through new peer to peer platforms like Airbnb, travelers are now open to the idea of

“non-hotel” and Serviced Apartment which are gaining more popularity. Condotel and Apart Hotel have also been getting momentum in terms of guest curiosity on the product types and willingness to try.

Currently there is a shift of focus from the traditional serviced apartment operators to short term guests as they attempt to apply a cap to long terms guests and slowly develop a higher proportion of short term guests. However, considering the differences in facilities and operational characteristics, question arises as to whether it is possible.

WHO OPERATES THEM?

Serviced Apartments have always been a very niche market for management companies. Numerous hotel operators do not have a specific serviced apartment brand but rather use a well-known brand with a slight modification to the name, for instance Novotel Suites or Holiday Inn Suites. However, as this sector evolves and demand increases some international hotel operators started to create specific brands to target long term oriented properties, for instance, Executive Residency by Best Western or Shama from Onyx Group. There are operators that are specialized in Serviced Apartment such as Frasers and Ascott.

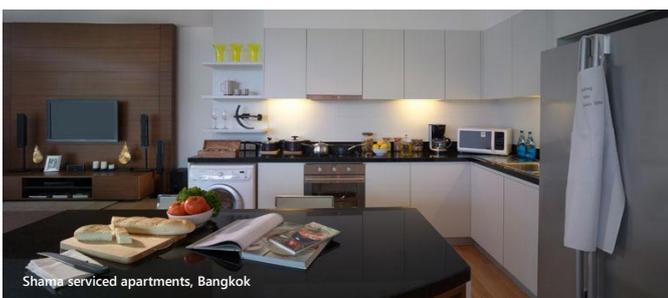


But the question that developers should ask themselves is “Do I need a third party operator?” and the answer is always “It depends”.

WHAT IS THE KEY FOR HEALTHY IRR?

When comparing Hotel to Serviced Apartments, the main factors influencing IRR and feasibility are: **Design and Operational Performance.**

Design largely influences a project’s IRR. Developers need to consider that, ceteris paribus, Serviced Apartments offer a lower revenue psm compared to Hotel since the units are typically larger. For instance, if you take a 45+ sm Apart hotel unit and compare with a 24 sm Hotel room, the potential for revenues per available space, is now almost double for the hotel since we can fit 2 times the number of sellable units in the same space. On the other hand, the public space and facilities in a hotel should take more space compared to a Serviced Apartment’s facilities. Every product should be consistent with its positioning, that is still the key to success.



Shama serviced apartments, Bangkok

For instance, given 10,000 sm of available gross space, below could be a typical number of keys of an Upscale Hotel compared to an Upscale Serviced Apartment.

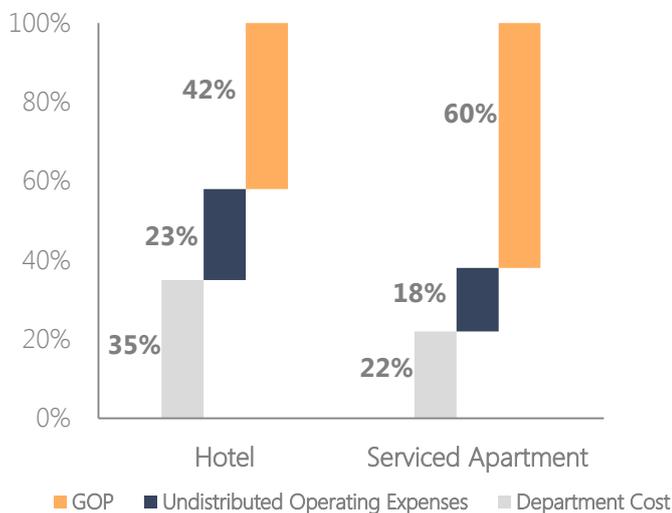
Example of 10,000 sm of GFA available

CATEGORY	UPSCALE HOTEL (4+/5)	UPSCALE SERVICED APARTMENT
No. of Keys	120 - 140	110 - 130
Standard Room Size	32 - 35 sm	55 - 65 sm
Circulation & Corridor	35% NFA	25% NFA



It is clear that space planning and space engineering are fundamental for the IRR. Poor design planning will result in a much lower IRR. Developers should be very well prepared when selecting business positioning and ensure the design reflects that.

From a business point of view, Hotel and Serviced Apartments have fundamental differences in operational revenues and costs. Hotels are typically able to achieve higher rates per room, due to the intrinsic characteristic of short term business. In addition, hotels achieve higher income from other sources, including F&B and ancillary. From the other side, the occupancy of Hotels is much more volatile and operating costs are considerably higher. Therefore, Hotels have higher revenues but higher costs, the questions is, what about profit? Below is a simulation of stabilized performance of an upscale Hotel (4+) and an upscale Serviced Apartment with the same number of keys.



UPSCALE HOTEL (4+/5) (LONG TERM)

200 keys
 US\$120 daily room rate
 70% average occupancy
 US\$ 6,132,000 room revenue
 US\$ 3,301,846 F&B revenue & other
 US\$ 9,433,846 total revenue
 42% GOP margin
 US\$ 3,962,215 GOP

UPSCALE SERVICED APARTMENT (LONG TERM)

200 keys
 US\$2,300 monthly room rate
 90% average occupancy
 US\$ 4,968,000 room revenue
 US\$ 876,706 F&B revenue & other
 US\$ 5,884,706 total revenue
 60% GOP margin
 US\$ 3,506,824 GOP

The above example is a hypothetical case of how long term vs. short term stay affects the return. However, the majority of the Serviced Apartments now, as stated previously, are shifting their attention to shorter term guests. This will increase revenue but also require more facilities, more staff and therefore more costs, going closer to the typical Hotel model. Serviced Apartment GOP margin is heavily dependent on the choice of targeted clients, positioning and facilities offering. There is a lack of transparency in term of benchmarking of operational data, however, from our experience, the below GOP margin range can be a source of reference:

- **65-70** % – Limited facilities, long term guests.
- **55-65** % – Upper Midscale to Upscale, selected facilities, long term (<60%) and short term guests.
- **45-55** % – Midscale to Upscale, selected facilities, mainly short term guests (>60%)

Net Operating Profit is not the only reference for IRR, construction costs also play a very important role into the choice of Hotel vs. Serviced Apartments.



Hotels are generally a much more expensive investment per room basis, considering all the public space and back of house required by the business. Serviced Apartments could be very cost effective to build, if the intention is stable longer term guests with limited facilities but, again, modular design and efficient use of the space would be a key for reducing costs. If asked what is the other important factor to reduce costs the answer would undoubtedly be, the "Correct Planning" before design commences. In our experience, if the business model and area program are well set and approved from the beginning then the developer, investor, designer, management company and contractor are all on the same page from start to finish, and that is the best way to save costs.

Finally, related to performance, market studies will be an important part of the planning work with correct analysis about market volume for long term stay. The Developer should be well aware that Serviced Apartments are less suitable in destinations with weak corporate demand.

WHAT ABOUT A MIX OF HOTEL & SERVICED APARTMENTS?

In several cases, we are involved in a mixed-use business model of Hotel and Serviced Apartment components in the same building. The first question we need to analyse is: "Would this model work?" Theoretically, it is a healthy combination since the property can share back of house and some facilities (or all in some cases). If the Serviced Apartment would like to be perceived as an independent component from the Hotel and increase comfort of long term guests, then some facilities and public areas, for instance, reception and dedicated elevators should be separated from the Hotel.

However, this mixture requires the building to be large enough for the two components to function properly and for the Hotel part to absorb the operational costs of the additional facilities. In certain cases, for small scale properties, developers tend to include some Serviced Apartment floors as "additional large rooms" targeting longer term demand.

This option, even if "logical" from a strategy of capturing different demand, could lead to lower IRR since the long term rooms will naturally tend to produce lower revenues per sm while the operation cost will still be higher due to the Hotel full services. One option in the latter case could be "Hotel&Suites" where the combination of rooms and suites would allow a price premium over the larger units even in case of long term guests. Once again, a careful study of the market, design and consistency in positioning and services is the best way to assure IRR.



Serviced Apartments can be an excellent choice for developers looking for a more stable cash flow, easier planning and operation but it could also be a good option for extra rooms for IRR if the positioning and business model is set to embrace also Hotel characteristics. The planning stage still plays a fundamental role in success, leading the path to well implemented design and choice of the right operator or brand. Exit plans do exist in the extent of large number of investors, private or institutional, looking for stable cash flows in key cities.



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