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# Focus **On:** The London Serviced Apartment Sector

Knowledge, strategy **results**

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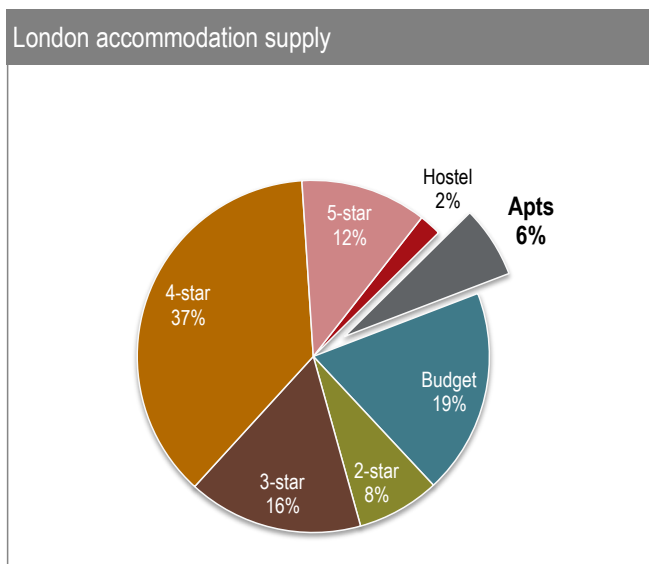
## Introduction

What is a serviced apartment? This question can be difficult to answer given the high number and different types of independent short-term let accommodation offerings in London. The line between residential and hotel accommodation is often unclear with many properties being part of a residential, hotel or mixed-use development. The situation is further complicated as serviced apartments are not a specific use class under UK planning legislation, resulting in some assets being classified as C1 (Hotels) and others as C3 (Residential Apartments).

For analysis purposes we have derived the following definition of a serviced apartment:

“A serviced apartment is a commercially registered business with a specified entrance, dedicated reception or guest services team. It includes a small kitchen, bathroom and living area and provides regular housekeeping services. It can also offer hotel-like services such as restaurants, business facilities and laundry services”.

## A growing sector still at an early stage



Source: AM:PM

Serviced apartments, corporate apartments and extended stay hotels are relatively recent products in the lodging industry that have gained significant popularity in recent years, thereby representing a significant competitor for conventional hotels. Particularly for corporate guests and personnel relocating either temporarily or permanently, serviced apartments have become an attractive alternative to the standard hotel product.

London is the most mature serviced apartment market in Europe, although still one of the smallest markets internationally. The sector is underrepresented when compared to other gateway markets such as New York, Sydney or Hong Kong where major brands have established a strong presence and apartment supply numbers per visitor are much higher.

According to hospitality intelligence provider AM:PM, total room supply of serviced accommodation in London comprises of about 8,000 rooms, equating to a market share of 6% of total accommodation supply.

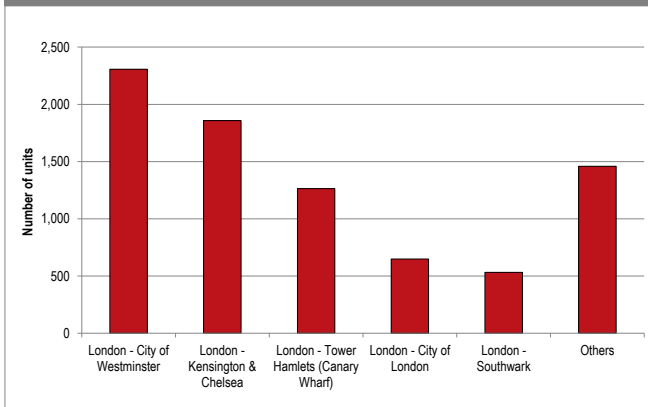


SACO Apartments, Vauxhall Bridge



Cheval Phoenix House, Westminster

Serviced Apartment Supply by Borough



Source: AM:PM

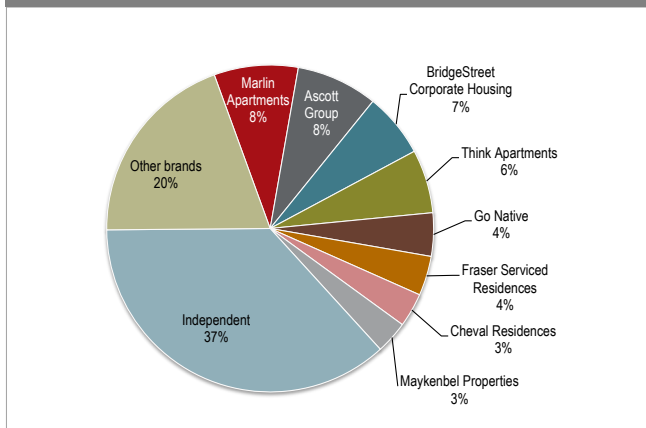
The areas with the largest concentration of serviced apartments in London are Westminster, Kensington & Chelsea and Canary Wharf. Whereas serviced apartments in Canary Wharf and the City cater primarily to business guests, serviced apartment accommodation in the West End and Knightsbridge has become particularly popular among leisure guests.

Growing demand, along with planning restrictions and limited expansion opportunities in core central London, has shifted development outside the city centre to the east and south east. Docklands, for example, has benefited from substantial regeneration with various brands such as Marriott, Frasers Suites or BridgeStreet establishing a presence in this part of the capital. In particular, Canary Wharf now has a very high density of serviced apartment accommodation.



Cheval Apartments, Knightsbridge

Major Serviced Apartment providers in London



Source: AM:PM

Around 60% of total serviced accommodation in London is branded, a high percentage in comparison to other locations in Europe where the majority of stock is still independently operated.

In terms of numbers of establishments, the majority of serviced apartment accommodation is categorised as mid-market, followed by economy and luxury in third place. Economy and mid-market establishments are most prominent in the city and cater for the bulk of business travellers looking for accommodation close to their office. Luxury accommodation, on the other hand, is mainly concentrated in the West End.

In terms of operating structure a large number of serviced apartments in London are owned and operated, with a minority being operated under lease or management agreements. Franchises are not common, however operators like BridgeStreet are exploring this opportunity. Serviced apartment operators (similar to hotel operators) tend to prefer management agreements, although some operators would consider leases in strategic locations.

The largest operators in terms of total units (in London) are Marlin Apartments, followed by the Ascott Group, BridgeStreet, Think Apartments and Go Native. In terms of price and brand positioning, Maykenbel properties and Cheval Residences have a strong presence in the luxury segment. In the upscale segment, Frasers Serviced Residences and BridgeStreet are established operators, whilst AKA are looking to increase their upscale presence marked by the opening of the AKA West End in October 2013. Citadines and Go Native are the most dominant mid-market providers.

## Supply growth continues

The serviced accommodation market in London has seen a surge of new openings, driven by a high demand for both short and long term accommodation, the resilience of the lodging market and the relative scarcity of serviced accommodation stock.

Fuelled by the London Olympic Games, development activity was particularly strong in 2012 and a total of 11 establishments with 798 units entered the London serviced accommodation market. Notable openings included the 133 unit Grosvenor House Apartments on Park Lane under the Jumeirah Living brand. Owned by Park Lane Properties, the apartments were originally built in the 1920s and have undergone a complete internal rebuild and refurbishment. The InterContinental Hotels Group also opened its first Staybridge Suites during June 2012, comprising 162 apartments. After opening, the property was sold to M&L Investments and is operated by Cycas Hospitality under a lease agreement.

The expansion of supply continued into 2013 with two new serviced apartments entering the market: the 27 unit Suffolk Lane by BridgeStreet in the City of London and three Apple Apartments (located in Cutty Sark, Stratford and Temple) comprising a total of 71 units.

There are currently five confirmed serviced apartment projects with a total of 377 units in the development pipeline. If all projects get realised by the end of 2015 service accommodation supply is expected to increase by 4%. However, supply growth could be higher considering that a significant amount of developments are currently in the planning stage. Furthermore, it also excludes Ascott's initial plan to transform the 230 room Cavendish Hotel into serviced apartments. The Singapore based owner and operator had acquired the hotel in October 2012 for a sum of £159 million.

With tight supply conditions and limited land for development, converting secondary offices to serviced apartment use will continue to be an attractive opportunity for developers. Location, however, will be critical for serviced accommodation development to become viable. Outside central London, serviced accommodation developments are often less attractive due to significantly lower occupancy levels. In these markets, residential or hotel developments tend to become more feasible.

## Planning requirements for serviced apartments

Serviced apartments are not specifically identified within the Use Classes Order, and tend to be classified as either C1 (Hotels), C3 (Dwellinghouses) or sui generis. The classification is normally based on the nature of the property and business, and in some cases a property can have a mix of classifications.

In London, specific legislation sets a minimum length of stay of 90-days for properties with planning consent under the C3 use class. Where shorter lettings are anticipated a C1 or sui generis consent will be required. For developments, such classification should be set within the original planning consent, and this will take into account such things as the facilities on offer, the method of management of the asset and the type of guest that the business expects to attract.

A serviced apartment offering short lets, but with permission for use within class C3 runs the risk of enforcement proceedings by the local authority. In order to continue and comply with planning regulations an application for change of use would be required. The success of such an application would depend on the specific policies adopted by the local authority.

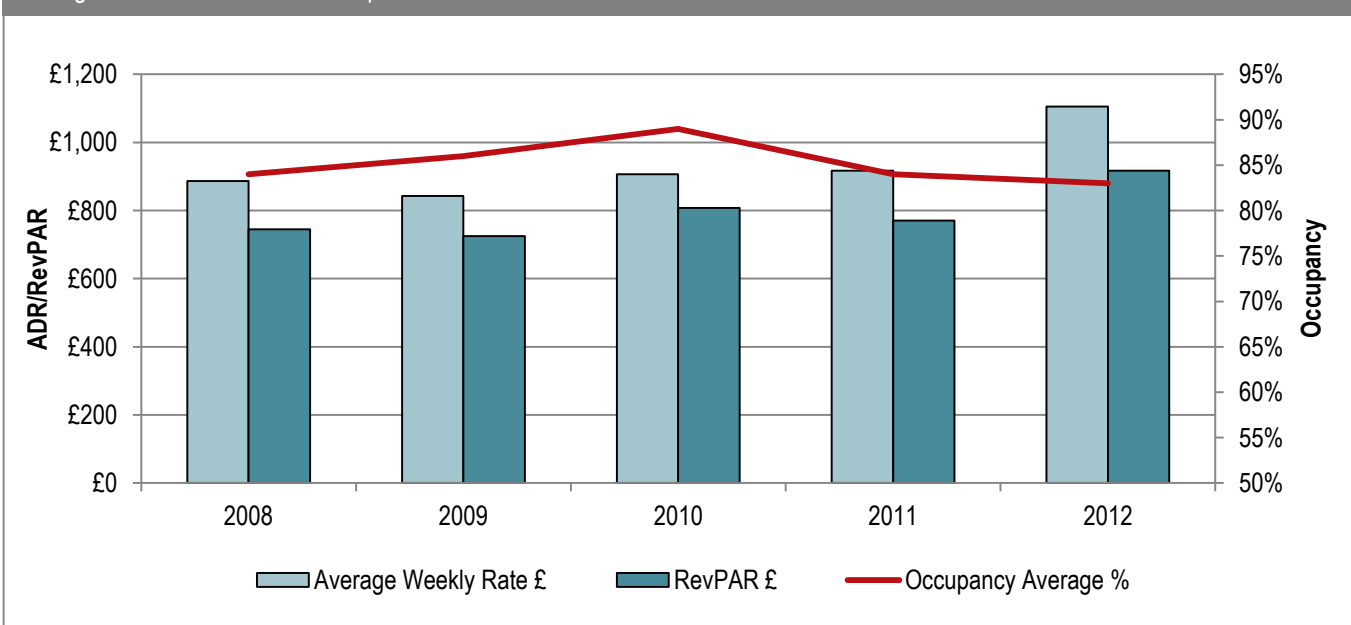
In many cases, serviced apartments are viewed favourably by planning authorities as they contribute to growth in the tourism sector and job creation, although there are also arguments against losing existing dwellings due to shortages in housing supply, particularly in central London. In these instances, converting residential apartment blocks to serviced apartments could prove to be challenging.



Citadines High Holborn, Covent Garden

## Higher occupancy levels than hotels

Trading Performance of Serviced Apartments in London



Source: Association of Serviced Apartment Providers (ASAP)

Serviced apartments in London tend to post an average weekly rate of about £900 to £1,000 with occupancy usually at around 85%. Occupancy is therefore slightly higher when compared to the hotel sector where average occupancy levels are at around 81%. In prime locations such as the West End, occupancy tends to exceed the 85% mark with average room rates significantly higher.

The serviced apartment sector in London was not immune to the financial crisis that started in 2008, witnessing a 5% decline in weekly rates in 2009 according to the Association of Serviced Apartment Providers (ASAP). The market, however, quickly rebounded in 2010 with occupancy climbing to an impressive 89%. Market conditions became more difficult in 2011 due to the Eurozone crisis and occupancy fell to an average 84%, with weekly rates remaining largely stable. Due to the London Olympics, 2012 was a success for most serviced apartment providers as weekly rates grew 20% to a new record of £1,105. Occupancy, on the contrary, remained comparatively flat at 83%, reflecting weak demand during the pre-Olympic months of May to July.

Q1 2013 proved to be more challenging for London serviced accommodation providers with occupancy at around 77%, whilst weekly rates remained stable at £1,102. The general London hotel market saw a similar trend with RevPAR declining 5.6%. Results in both segments were negatively impacted by poor weather conditions and Easter falling into March.

Due to a greater average length of stay, serviced apartments are not as exposed to the decrease in demand on weekends experienced by many hotels located close to commercial locations. In terms of seasonality, demand for serviced apartment accommodation is driven by corporate events and holiday periods with low demand typically between December and March. The strongest months are usually June and July with occupancy exceeding 90%.



The Apartments at the Athenaeum, Mayfair



## Trading performance outlook remains positive

The sector is forecast to continue to perform strongly in coming years as improving economic conditions drive corporate demand. According to The Apartment Service Worldwide, the market is still considered undersupplied with London having just 1.2 apartments per 1,000 business visitors compared to New York (5.2), Hong Kong (5.3), Sydney (2.6) and Singapore (1.8). Hence, future growth in London supply is not anticipated to adversely affect growth in performance.

This positive sentiment was also reflected in a recent survey conducted by ASAP which revealed strong levels of optimism with 74% of serviced accommodation providers expecting business to increase in 2013.

Overall, we are of the opinion that the outlook for the London serviced apartment market is very positive for the following reasons:

- Total serviced apartment supply as a percentage of total serviced accommodation is low when compared to more mature international markets, therefore supply gap opportunities exist;
- Increase in competitiveness of branded serviced apartment operators will increase public awareness and promote the sector when compared to hotel stock;
- Strong operational performance when compared to other sectors with very positive forecasts for rental growth and capital value.
- Strong demand for serviced accommodation, particularly from the Middle East.

## More profitable from a management perspective than full service hotels

Driven by high occupancy levels and lower operating costs, GOP and NOP margins are significantly higher in the serviced accommodation sector when compared to full service hotels. This is primarily due to the less intensive levels of service which often has no direct food and beverage services, resulting in lower payroll costs. Staffing is also more cost effective with centralised management and cleaning teams. A general manager, for example, might be assigned for a cluster of three to four serviced apartment properties. Furthermore, lower turnover of rooms and a high proportion of business traveller guests provide less guest room 'wear and tear' compared to hotels that have a shorter length of stay.

Below we have a comparison of the average GOP and NOP margins of a standard serviced apartment and a standard full service hotel in London.

### Profit Comparison: London Hotels vs. Serviced Apartments

	Serviced Apartments	Full Service Hotels
GOP margin	60-85%	40-50%
NOP margin	50-75%	30-40%

Association of Serviced Apartment Providers (ASAP)

It must be noted that these margins may vary significantly depending on the type of serviced apartment. Serviced apartments that offer more substantial levels of service may have significantly lower profit margins.



Grosvenor House Apartments, Mayfair

## Attractive yields in the serviced apartment sector

As the sector is still at an early stage, development has been the primary way for investors and operators to gain a foothold in the London serviced accommodation market. Hence, transactional evidence is still comparatively limited.

Nonetheless, recent serviced apartment acquisitions have shown attractive yields when compared to other London real estate classes. Yields for serviced apartments in central London have been at around 5.0%-6.0% and therefore exceed average prime yields for residential apartments (3.5%) and hotels (5.5%).

Notable transactions include the sale of a 9 unit serviced apartment property in Monument Street in the City of London in January 2012. The property was purchased by a private family UK trust for £4.75 million with a net initial yield of around 5.5%. The price per unit equated to £539,000. Another noteworthy deal occurred in July 2011 with the sale of Wardrobe Court, a block of 92 serviced apartments to British Land for a reported £56 million. The yield was close to 5%, with the price per unit at £609,000.

More recent transactions include the StayBridge Suites Stratford, which was sold as part of a two property portfolio (the Holiday Inn Stratford being the second property) for an estimated £64 million to Singapore-based Real Estate Investment Trust M&L Offshore Investments Ltd. The properties were sold at an initial yield of 7.0%. In September 2013, the Grand Plaza Serviced Apartments in Bayswater was sold for approximately £98 million. The property was sold to the Federal Land Development Authority of Malaysia for an estimated yield of 5.5%.

A recent market offering (as at October 2013) is the Circus Apartments by BridgeStreet in Canary Wharf. If sold for the asking price of £30 million the sale will represent an approximate yield of 4.7%.

Both local and foreign investors have entered the London serviced accommodation market. Domestic investors, often in the form of institutional investors, have been particularly interested in leased opportunities providing stable income streams. Foreign investors, on the contrary, have been predominantly involved in luxury developments with a stronger focus on capital value preservation.

## Investor sentiment to remain strong

In light of positive market fundamentals, limited new supply, and strong levels of profitability, we are likely to see increasing investor interest and further capital value growth in the foreseeable future. Investor interest is growing in both diversity of investor type and the number of active investors operating within the sector.

Traditional residential investors were initially the most common type of serviced apartment owner, which is understandable given the similarity of the asset classes. However, other buyer types such as institutions have been attracted to the sector by stable operating results coupled with strong underlying residential real estate values. In addition, growing interest from specialist serviced apartment operators to expand or enter the market has resulted in more strategic purchases for branding purposes. High net worth cash-rich investors, private equity funds are also keeping a close eye on the sector, although their primary focus remains largely upon luxury development opportunities located within central London.



Grand Plaza Serviced Apartments, Bayswater



## Appendix 1: London Serviced Apartments Supply and Pipeline

### London Serviced Apartments Supply and Pipeline

Hotel Name	Units	Location	Address	Operator	Opening
<b>Recent Openings</b>					
Assam Lofts	29	Aldgate East	33-35 Commercial Road	Go Native	2012
AKA West End	10	Bond Street	5 Bentinck Street	AKA	2012
MAX at Clapham	13	Clapham North	Clapham High Street	Max Serviced Apartments	2012
Roseberry Avenue	58	Farringdon	20 Roseberry Avenue	Supercity Aparthotels	2012
Staycity Serviced Apartments London Heathrow	144	Hayes	Highpoint Village, Station Approach	StayCity	2012
Go Native Stratford East	159	Ilford	Pioneer Point, Winston Way	Go Native	2012
Grosvenor House Apartments by Jumeirah Living	133	Marble Arch	Park Lane	Jumeirah International	2012
MAX at Richmond	15	North Sheen	Garden Road	Max Serviced Apartments	2012
Go Native at Sussex Gardens	63	Paddington	208 Sussex Gardens	Go Native	2012
MAX at Aldgate	12	Shadwell	Wilson Tower, 16 Christian Street	Max Serviced Apartments	2012
Staybridge Suites London Stratford City	162	Stratford	10B Chestnut Plaza	Cycas Hospitality	2012
Nadler Soho	78	Tottenham Court Road	10-12 Carlisle Street / 21-25 Anne's Court, Soho	Nadler Hotels	2013
Suffolk Lane by BridgeStreet	27	Cannon Street	2 Suffolk Lane / 28 Bush Lane	BridgeStreet Corporate Housing	2013
<b>Total</b>	<b>903</b>				
<b>New Developments</b>					
Cheval Three Quays	97	Tower Hill	Lower Thames Street	Cheval Residences	2014
Trocadero - apartments	56	Piccadilly Circus	Shaftesbury Avenue / Rupert Street	Bespoke Hotels	2014
Tobacco Dock (apart-hotel)	63	Shadwell	Wapping Lane	Al Mubarakia	2014
10 Trinity Square	41	Tower Hill	10 Trinity Square	TBC	2015
Four Seasons Residence	120	Liverpool Street	128-150 Bishopsgate / Devonshire Row / Houndsditch	Four Seasons Hotels & Resorts	2015
<b>Total</b>	<b>377</b>				

Source: AM:PM

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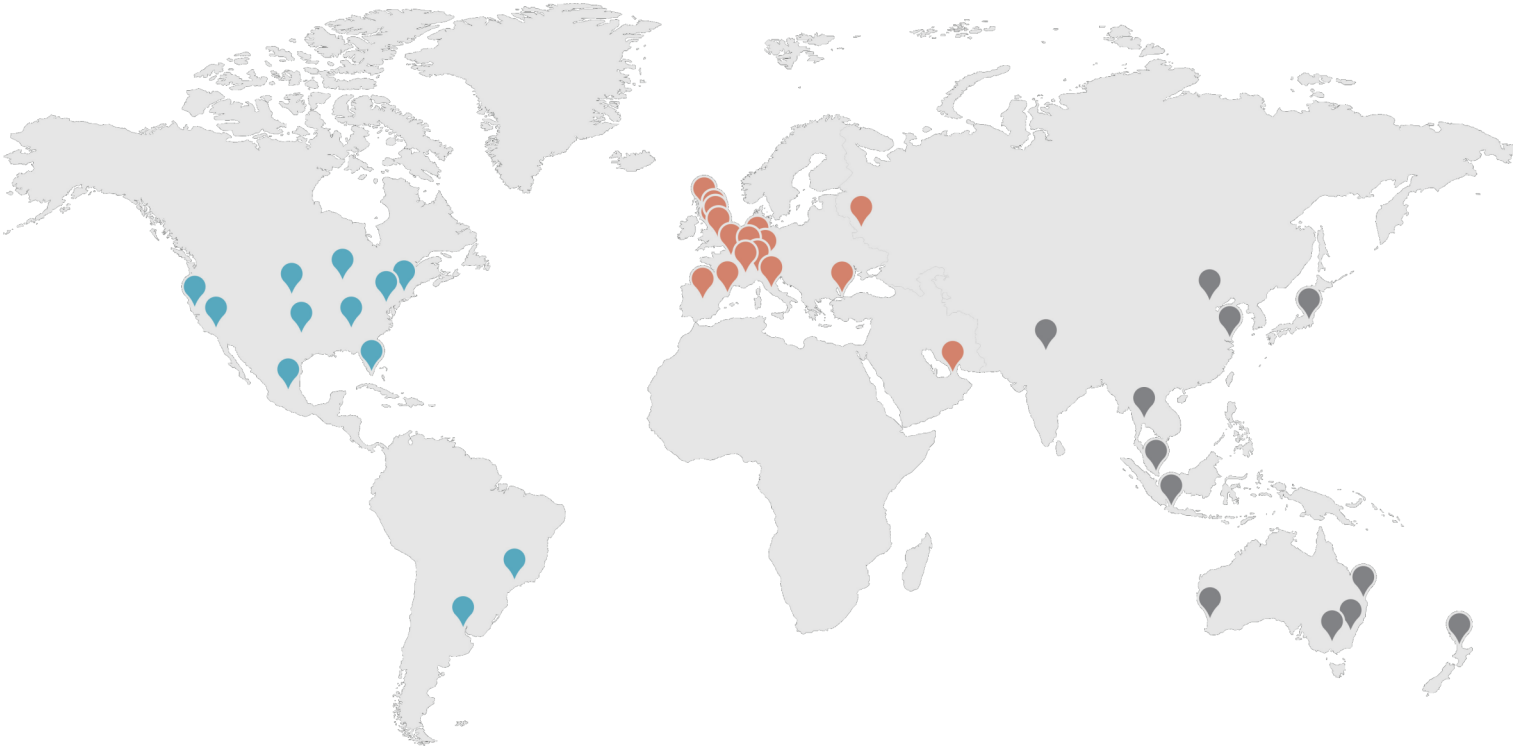
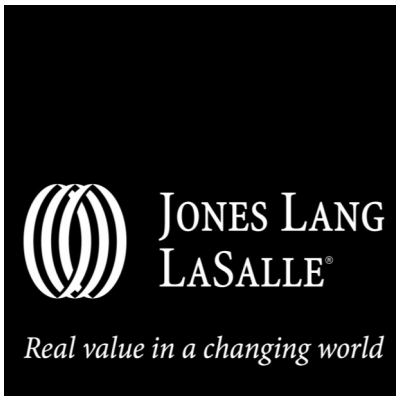
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