This report analyses the performance of Hong Kong's Hotel Market

Knight Frank

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Hong Kong Hotel Report

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ABSTRACT

The Covid-19 outbreak has had a detrimental impact on the hospitality industry and has continued to reshape the industry and its business models. Given the prolonged absence of inbound tourism, Hong Kong hotel operators have shifted their business models to adapt and adjust to and accommodate the unprecedented setback.

Given the lessons of the past almost three years since the Covid-19 outbreak, local hotel operators have tap the emerging trend of local staycations and long-term rental accommodation. This has allowed them to secure more stable cash flow and occupancy considering the market downturn. Existing and new hotels have also offered a broad spectrum of services and various value-added products as a new growth driver to attract domestic guests, such as themed, F&B and wellness staycation packages.

In view of the current structural changes in the local hotel sector, some owners downsized their hotel business by converting their facilities to other uses. Other owners and operators began asset enhancements in their hotels to attract tourists in expectation of the further relaxation of border control measures and a rebound in inbound tourism.

Hotel investment activity, on the other hand, is gaining steam. Investors have been actively seeking opportunities to acquire hotels in convenient locations and convert them into long-term stay, co-living or other alternative uses. Although the hotel market is recovering, challenges remain, including a labour shortage, rising wages and volatile demand. Looking ahead, as economies continue to reopen, and given the likelihood of more relaxed travel restrictions, we expect the positive momentum to continue through the remainder of 2022 and into 2023.

No. of 5-star hotel rooms by August 2022

21,471

New supply of 5-star hotel rooms in 2021

447

Average daily rate (ADR) of 5-star hotel rooms in first 8 months in 2022

HK$1,671

(+16.5% YoY)

Hotel occupancy rate in of 5-star hotel rooms in first 8 months in 2022

56%

(+ 15 ppt)

INTRODUCTION

The coronavirus pandemic has hit Hong Kong's hospitality industry hard, as stringent social distancing measures, lengthy quarantine regimes, and travel restrictions have kept tourists away. Last year, the hotel industry suffered its worst year on record, as the coronavirus pandemic severely curbed both business and vacation travel. Hong Kong had only 89,190 international overnight visitors in 2021, compared to 1.4 million in 2020, a drop of 93.4% year on year (YoY), according to the Hong Kong Tourism Board. Visitors from the Chinese mainland, which constituted 72% of the total visitor arrivals in 2020, also dropped significantly by 92.7% YoY to 64,641.

Amid the poor market conditions, 10 hotels with 3,013 rooms shut down their operations in the three years since 2019. Notably, The Excelsior, in Causeway Bay, suspended its operations in 2019, with plans to redevelop the hotel into a 26-storey Grade A office tower; the 79-room Hotel Pennington by Rhombus, in Causeway Bay, shut down in March 2020, with plans to convert it into an office building as well; and the 160-room Shamrock Hotel, located in Jordan, ended its operations in June 2020, and is currently looking for potential buyers or investors.

Stepping into Q4 2022, although border restrictions have been gradually lifted, international arrivals remain weak. This report looks at the performance of hotels in Hong Kong in 2022, new supply, key trends, challenges and strategies in the hotel sector, and the industry's outlook and opportunities.

HOTEL PERFORMANCE IN 2022

The stringent social distancing rules and travel restrictions have taken a heavy toll on the local hotel industry. Only in May 2022, when the fifth wave of COVID-19 in the city gradually came under control was there a rebound in tourist arrivals. Overnight visitor arrivals in Hong Kong bounced back to 175,852 for the first eight months of 2022, up 234% YoY, and in August 2022, there were 56,499 overnight visitors, up 529% YTD. Hotel performance also improved because of local staycation demand and hotel quarantine demand, which raised ADR and occupancy.

The occupancy rate for the first eight months of 2022 increased 15 percentage points YoY to 56% for High Tariff A hotels and 11 percentage points YoY to 71% for High Tariff B hotels. But the occupancy rate of Medium Tariff Hotels decreased 5 percentage points to 66%. The ADR of High Tariff A hotels for the first eight months was HK$1,671, increasing 16.5% YoY, and the ADR of High Tariff B and Medium Tariff hotels increased 31.8% and 47.1% YoY, respectively, to HK$820 and HK$687.

HOTEL SUPPLY

Given the severe impact of COVID-19 on all aspects of the society, only two new High Tariff A hotels opened in 2021: The Arca in Wong Chuk Hang, Southern District, with 187 rooms, and the WM hotel in Sai Kung, with 260 rooms. Some other High Tariff A hotels, such as The Silveri, MGallery by Sofitel, and Aki Hong Kong Mgallery, which were expected to open in 2021, have seen delays. As at the end of August 2022, there were 41 High Tariff A hotels in Hong Kong and 21,471 High Tariff A hotel rooms.

Table 1: List of new hotels opened in 2021-2022

Quarter Opened	Location	Name of Hotel	No of rooms
2021 Q3	Wong Chuk Hang	The Arca	187
2021 Q3	Tsim Sha Tsui	Hillwood House Hotel	82
2021 Q3	Sai Kung	WM Hotel	260
2021 Q3	Yau Ma Tei	Green Jade Hotel	38
2022 Q1	Chek Lap Kok	Regala Skycity Hotel	1,208
2022 Q1	Tai Kok Tsui	Starphire Hotel	154
2022 Q1	Sheung Wan	Lander Grand Hotel	51
2022 Q2	Wan Chai	China Rich Hotel	78
2022 Q2	Wan Chai	J Link Hotel	80
2022 Q2	Tung Chung	The Silveri Hong Kong-MGallery	206
2022 Q3	Wong Chuk Hang	The Fullerton Ocean Park	425
2022 Q3	Wan Chai	Aki Hong Kong-MGallery	173

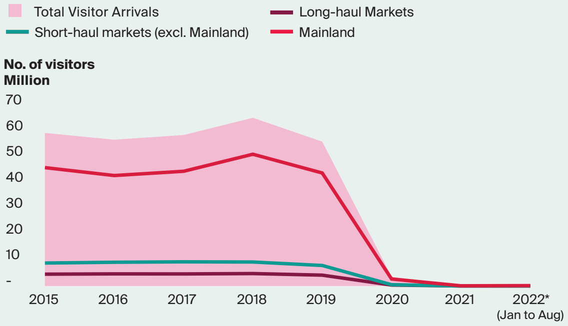
*Excluded serviced apartment and hotels renovations
Source: Knight Frank Research / Hong Kong Tourism Board

Table 2: New confirmed hotel projects as at September 2022

Planned Date of Completion	Location	Property	Developer	No of rooms
End 2022	Eastern Hong Kong	A proposed hotel at 225 - 227 Shau Kei Wan Road, Shau Kei Wan, HK	Meridian International Holdings Limited / 39 Plus Limited	60
End 2022	Yau Tsim Mong	A proposed hotel at 5, 7 & 7A Hillwood Road, Tsim Sha Tsui, Kln	Ie, Siu & Chung Architects Limited	91

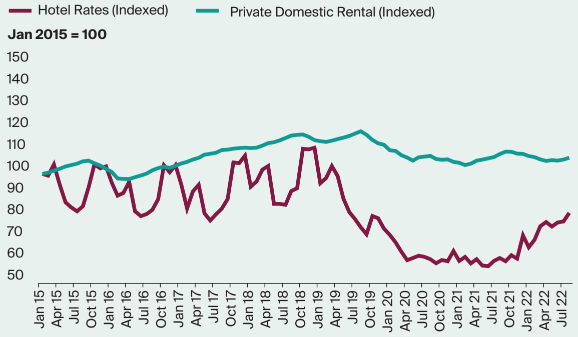
Source: Knight Frank Research / Hong Kong Tourism Board

Chart 1 : Total visitors arrivals to Hong Kong from 2015 to 2022*



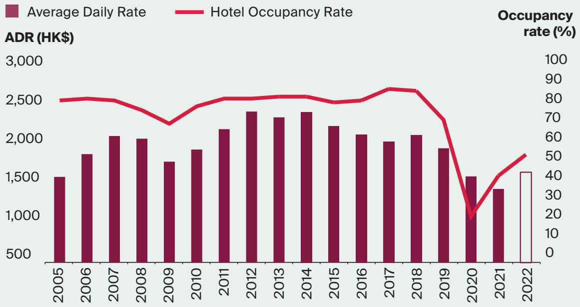
Source: Hong Kong Tourism Board / Knight Frank Research

Chart 2 : Rental Rates of Hotels and Private Domestic Housing



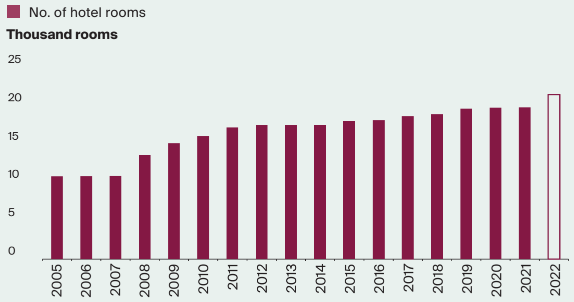
Source: RVD / Knight Frank Research

Chart 3 : Hong Kong's high tariff A hotel performance



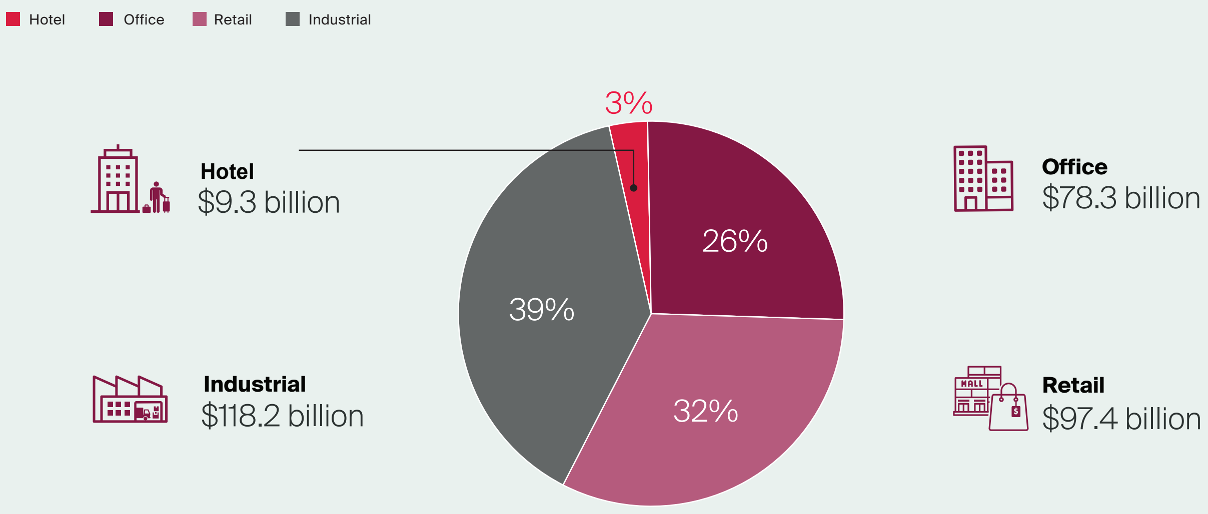
Source: Hong Kong Tourism Board / Knight Frank Research

Chart 4 : Hong Kong's high tariff A hotel stock



Source: Hong Kong Tourism Board / Knight Frank Research

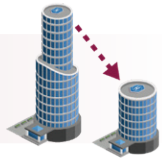
Chart 5: Commercial property transactions in the past 12 months



Source: RCA / Knight Frank Research

KEY TRENDS

01 Scaling down the hotel business



In the face of the subdued hospitality market, some hotel owners scaled down their hotel business, aiming to unlock property value by renovating hotels for other uses, predominately residential. At least seven planning applications were submitted to the Town Planning Board (TPB) for conversion to residential use since 2020, providing approximately 4,823 flats.

For instance, CK Asset granted TPB's approval with conditions to renovate the two existing blocks of Harbour Plaza Resort City in Tin Shui Wai, providing 1,102 flats, a reduction of 78% from 5,000 in the previous redevelopment plan. The completion date will be shortened to 2028. Another CK Asset hotel, the Horizon Suite Hotel, will be renovated to provide 758 flats.

Other hotel redevelopment projects in Hong Kong Island and Kowloon include the Novotel Nathan Road Kowloon (which will provide 285 flats), the Ibis Hong Kong Central and Sheung Wan (284 flats) and the Travelodge Kowloon and three adjoining buildings (230 flats).

Hotel rates follow seasonal trends, while domestic housing has a far more stable and upward growth trend. Hotel investors and operators who prefer lower volatility cash flow, while still enjoying the upside of seasonal uptrends may opt for partial conversion to long-stay or co-living space.

Table 3: Hotel conversion into residential

Property	Location	Owner	Number of flats	Planning applications
Harbourview Horizon Hotel	Hung Hom	CK Asset	1,503	To renovate the 1980-room hotel providing 1,503 flats and retaining 442 hotel rooms, with commercial space
Horizon Suite Hotel	Ma On Shan	CK Asset	758	To rezone the site from hotel into a residential development providing 758 flats
Harbour Plaza Resort City	Tin Shui Wai	CK Asset	1,102	To renovate two 20-21 storey buildings providing 1,102 flats with commercial space. Scale reduces from 5,000 units in the previous plan
Novotel Nathan Road Kowloon	Tsim Sha Tsui	CSI Properties	285	To redevelop the 389-room hotel into a private composite building providing 285 flats, retail or F&B and office space
Travelodge Kowloon and three adjoining tenement buildings	Yau Ma Tei	Tai Hung Fai Enterprise	230	To redevelop the hotel into a 28-storey single block residence providing retail or F&B spaces with 230 flats
Ibis Hong Kong Central and Sheung Wan	Sheung Wan	Accor Group	284	To redevelop the 550-room hotel into a single block residential building providing 284 flats and retail space
Royal View Hotel	Tsuen Wan West	Sun Hung Kai Properties	661	To rezone the site for wholesale conversion of the hotel into a residential development providing 661 flats and an elderly day-care centre

Sources: Knight Frank Research / Town Planning Board

02 Hotel conversion into co-living space

Investment activity has been active for hotel assets amid the pandemic in the past two years. With travel restrictions in place, the hospitality sector has corrected appreciably. It is attracting interest from value-add investors interested in converting these premises into co-living or long-stay accommodation. Many of these investors are offshore funds, some of which have had limited investment exposure to Hong Kong.

A total of 17 hotel transactions have been recorded since 2020, totalling HK$12.7 billion. At least eight of them involve plans or have confirmed conversion into alternative uses, such as co-living or student accommodation, totalled HK$9.3 billion or 73% of the total transaction value during the period. From an investor's perspective, co-living premises provide more risk-adjusted returns than traditional real estate investments.

There has been a growing trend of partnerships between investors and operators for hotel acquisitions. International funds have been the main buyers of hotels via joint ventures with co-living operators and are entering the co-living market through acquisitions and conversions. These partnerships provide stable cash flow, given longer-term leases and high occupancy levels for co-living premises, allowing operators to scale up their business and increase margins.

Dash Living will operate the 148-unit Travelodge Central Hollywood Road, which PGIM Real Estate acquired for HK$850 million in February 2022. In addition, it entered into an agreement with Hines and MindWorks Properties to operate their HK$925 million-acquired property Butterfly on Prat, in Tsim Sha Tsui, in August 2021. Dash Living manages leasing, operations and community provisions in their managed properties under its brand. It charges a certain proportion of revenue as management fees to the property owners under this business model.

Weave Living forms joint ventures with investors to acquire en-bloc hotel assets for conversion into co-living space. Its acquisition of the 435-unit Rosedale Hotel in West Kowloon for HK$1.37 billion in June 2022, was part of a US$200 million JV with PGIM Real Estate. The latter has a 90% stake in the JV, while Weave has the remaining 10% stake and leads the repositioning and operations of the acquired assets. Another Weave Living JV with Angelo Gordon invested in the 214-unit Grand City Hotel in Sai Ying Pun for HK$900 million in May 2022, following its first acquisition of a 99-unit Kai Tak hotel for HK$390 million in July 2021.

Going forward, we expect hotel investment volume to hold up. The co-living sector is expanding in Hong Kong, with more investors looking for en-bloc hotels or apartment buildings to convert to long-term rental accommodation, given favourable fundamentals and strong rental demand. Once the border opens, these properties could be operated as hotels. More partnerships are expected between operators and investors or property owners in the acquisition, development and operation of the assets, leveraging the scale of efficiency of the operators. Operators can potentially increase rental returns to investors or property owners, and provide tech-enabled, ESG and sustainability offerings for the assets.

Table 4: Hotel conversion into co-living space

Date	Property	Buyers(s)	Amount (HK$)	No of rooms
September 2022	Hotel COZi Harbour View	Weave Co-Living	2.47 billion	598
June 2022	Rosedale Hotel Kowloon	PGIM Real Estate, Weave Co-Living	1.37 billion	435
April 2022	Grand City Hotel	Weave Co-Living, Angelo Gordon	900 million	214
January 2022	Travelodge Central Hollywood Road	PGIM Real Estate	850 million	148

Source: Knight Frank Research

03 Repositioning and/or asset enhancement

For hotel operators, adding value through repositioning has been an important strategy to improve their return on investment. With tourist arrivals at an all-time low, some hotels have taken the opportunity to reposition themselves, or to revamp their concept with upgrades and renovations. For instance, the Sheraton-Hong Kong Hotel, in Tsim Sha Tsui, started renovations in November 2021, and the first phase of 100 rooms and suites are now open to guests. The second phase of renovated rooms will be launched in December 2022. Another example is the InterContinental Hong Kong, in Tsim Sha Tsui, which ceased hotel operations in April 2020 to start large-scale renovations. After 30 months of renovations, it will be reopened and rebranded as the Regent Hong Kong in December 2022.

We expect to see some hotel operators take the opportunity amid the downbeat market to upgrade and enhance their assets. This will provide more long-term benefits, such as higher room tariffs, a new and broader clientele, and new income streams from non-room revenue to hotel owners.

04 Hotel themed-based elements as a growth driver

Hong Kong has one of the world's toughest border control regimes against COVID-19. Given the ongoing travel restrictions in Hong Kong, many Hong Kong people have turned to local hotels for an equally enjoyable staycation or day-use experience. And in the absence of inbound tourism, many hotel operators have readjusted their business model to target locals. A few theme-based hotels have opened in the past year to tap into different user segments based on local demand. By definition, a themed hotel features a specific motif throughout the hotel, including interior design, decor, dining and amenity facilities.

For example, the Fullerton Ocean Park Hotel, a family-friendly resort, that had a soft opening in July 2022, has six children's themed rooms, all of which offer a sea view. The rooms are designed to cater to guests of all ages and create fun memories for children. The hotel also provides family-friendly facilities, accommodation and dining packages, some of which are bundled with water park tickets, making it an excellent place for families with children, as well as couples and friends.

The Aki Hong Kong – MGallery is the first hotel in Hong Kong to feature a Japanese-style tatami room, which is ideal for guests who often travel to Japan for a "homecoming". These hotels have received a good response and high occupancy after opening. For instance, reservations started at the end of June at the Fullerton Ocean Park Hotel, with room rates starting at $2,400, and it had full occupancy in July. Room rates were adjusted to over $3,000 in August during the summer holiday.

Overall, the popularity and number of themed hotels in Hong Kong are on the rise. Theme-based elements play an essential role in determining the popularity of a hotel, so to increase the attractiveness and enhance the brand of a hotel, operators must do careful market research and ensure the theme matches the market trends. We expect theme-based hotels to be an alternative growth driver in the hotel industry amid the downbeat market.

05 Environmental, Social and Governance

Environmental, Social and Governance (ESG) measures have progressively become a strategic initiative for hotel operators. In general, ESG criteria in hotels may include energy and water efficiency, reduced carbon emissions, sustainable buildings, responsible and sustainable sourcing, social impact and transparent reporting.

A couple of hotel groups in Hong Kong have major ESG initiatives. The Rosewood launched "Staycation for Good" with Social Venture Hong Kong, offering a quarterly programme of meaningful stays that take families on journeys of insight and contribute to addressing pressing environmental and social issues. Hong Kong and Shanghai Hotels sends all recyclables to off-site recycling facilities or for upcycling by partner organisations. All the waste in the hotel is properly handled and disposed of by waste contractors or though take-back programmes from suppliers. The Fullerton Ocean Park Hotel Hong Kong has partnered with Urban Spring to offer smart filtered water refill stations, called "Well", all around the hotel as a sustainable option to replace single-use plastic water bottles.

To summarise, ESG measures are a growing priority for investors, hotel guests and other key stakeholders. Hotel operators should focus more on ESG measures to mitigate future risks.

OUTLOOK

Despite the gradual reopening of the border and the relaxation of hotel quarantine rules to "0+3", the outlook for hotel performance remains of concern.

The overall tourism industry is expected to remain weak in the short term. In our view, the end of the hotel quarantine policy may not bring many visitors, especially short-haul visitors to Hong Kong in the short term. Other Asian destinations that do not impose quarantine rules for visitors, like Singapore and Thailand, will continue to be more attractive than Hong Kong. Also, the HKD's link to the strong USD makes the city a less attractive destination for most tourists. Our high-value currency may also result in more Hong Kong people leaving for overseas holidays, thus dampening domestic demand. This may not change before 2024 when the US possibly starts slowing down its interest rate hike pace.

Before the border fully reopens with the Chinese mainland, we expect the hotel industry to recover at a slow pace. In the short term, operators need to be more flexible in providing and adjusting their products and services to cater to domestic hotel demand to secure occupancy and cash flow. It is certain that the new normal for the hotel sector will focus on a quality guest experience and differentiated products offerings.

The occupancy level and ADR of High Tariff A hotels are expected to remain at low levels in 2023, since domestic demand is unlikely to fill the demand gap from the loss of international and Chinese mainland visitors. But in the longer term, we expect both local and international tourism to rebound to 60-70% of Pre-Covid level, and the hotel industry to regain momentum when Hong Kong and Chinese mainland fully reopens thier borders.

We expect more investors to eye hotel conversion to long-stay rental accommodation in partnership with co-living operators. At this stage, we consider the co-living sector to still be in the early stage of development in Hong Kong. The sector is expected to evolve over time to cater to a more extensive tenant base.

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

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