UK Serviced Apartment market

“Serviced apartments, a real alternative to hotels and residential”

Philip Johnston, Head of Hotels

- Falling housing demand is providing expansion opportunities as developers become more open to leasing and management contracts on their unsold stock.

- The benefits of these agreements to developers is that they provide an income and the ability to sell units back on the open market at a later date.

- 3,400 known serviced apartment units are in the planning pipeline, the bulk of which are in London. Combined with existing units this will bring total supply in the UK to just over 10,500 units.

- 2009 will be a tough year operationally as companies cut travel expenditure in order to reduce costs. Overseas business visitor numbers were already down 10% in 2008 with a further 13% fall forecast of 2009.

- Cuts in companies travel expenditure is likely to mean a greater focus on ‘value for money’. This may prove beneficial as serviced apartments offer a more cost effective solution for long term stays than hotels.

- Serviced apartments are assessed against cashflow as opposed to residential values. This should help insulate values from the falls seen in residential values.

- By 2012 new build completions are forecast to be 45% lower than the five year average. This decline in new build residential stock will reduce opportunities to enter into lease/management contracts.
The onset of the recession will prove a challenging operational environment for the hospitality sector. While this will also be true for serviced apartments, it is offering expansion opportunities. With sales of new build flats down circa 80% in 2008 compared to 2007, developers are looking to new ways to secure income from their unsold stock. Committed supply likely to come to the market during the next 12-18 months totals 22,500 units, 16% of market turnover (including second hand residential) at the peak of the market.

As a result entering into a lease or management contract with a serviced apartment operator is proving an attractive option to developers as they offer an income and the ability to sell units back onto the open market at a later date. For example, a standard management contract could provide a developer an annual income, before management fees, in the region of £15,000 on a 1 bed flat (based on a nightly rate of £85 and 80% occupancy). Grosvenor have already capitalised on this having entered into a lease agreement with Bridgestreet on 78 units at their Liverpool One scheme.

Converting standard residential units to serviced apartments does raise potential planning issues. In London a change of use may be required as serviced apartments/apart-hotels tend to fall into hotel (C1) and not residential (C3) use. While it can be relatively straight-forward to obtain change of use on a site it can be a different story where the units have been completed under a C3 permission. Operators tend to get round this by applying for a daily letting license allowing them to lease units for less than 90 days. Outside of London, where there is less awareness of serviced apartments, its planning status is even less clear although we believe that this is likely to change.

Apart-hotel development is also set to increase with the entrance of new operators to the UK. Staybridge, part of Intercontinental Hotels Group, is a US operator actively expanding into the UK with its suite style product. Its first operation opened in Liverpool in 2008 with 132 units. A further opening will open in 2009/10 in Birmingham and Glasgow in 2010/11, with other operations planned for London.

In total there are 3,400 known serviced apartment/apart-hotel units in the planning pipeline. Combined with existing units this will bring total supply in the UK to over 10,500 units. London accounts for the bulk of this with just over 2,000 units, the majority of which are in Southwark close to London Bridge (South Central). Supply in the regional cities ranges from between 20 to 320 units. Leeds has the greatest potential future supply of over 300 units, with Edinburgh, Manchester and Birmingham not far behind with over 200 units. The reality is that future supply is likely to be in excess of this as lease/management contracts on standard residential units look set to continue.
Risks & outlook

Overseas business visitors down

While the recession has provided opportunities for expansion it does threaten operational performance. A recent survey by the CIPD and KPMG found that companies were cutting spending on business travel, 60% reducing international trips. Overseas business visits to the UK were down an estimated 10% in 2008, with a further 13% fall forecast for 2009. This is sure to have repercussions on the sector as its previous expansion had been fuelled by the growth in business travel.

When it comes to longer term stays, visitor numbers would appear to be more robust. Visits of more than three months were up 25% over the first three quarters of 2008, with total visits for the year still in line with the five year average (30,000 visits). Cuts in travel expenditure also means that businesses will be looking more closely at costs, which may prove beneficial. Serviced apartments offer a more cost effective solution for longer term stays compared to hotels. Significant discounts are often applied to advertised rates, sometimes in the region of 30% for stays over 28 nights. These discounted rates, plus the fact that they avoid additional costs such as room service and the need to eat out, means that serviced apartments offer a competitive alternative to traditional hotels.

What’s the outlook for 2009 and beyond?

It would be delusional to think that this year and the next is not going to be tough operationally. Cuts in business travel budgets and redundancies, particularly in the financial and business services sector, traditional key end users, will all take its toll. But its not all doom and gloom. The fact that serviced apartments can achieve average occupancy levels above the local hotel market combined with the general flexibility of serviced apartment inventories should help maximise occupancy levels allowing operators to weather the storm. With serviced apartments valued against cashflow as opposed to residential values, which fell 15% over 2008 and forecast to fall a further 11% in 2009, should help insulate values.

We believe the more successful operators will be those that can balance operational performance with expansion, as we suspect that beyond 2009 these opportunities will be harder to come by. With residential completions already on the wane and set to recover to only 87,000 by the end of 2012 (45% down on the five year average) suggests that operators will find it harder to expand through the use of lease and management contracts on standard residential stock. This may prompt a move towards more dedicated apart-hotel development. Obtaining development sites, or at least entering into development agreements, while land values are relatively ‘cheap’ may be key to meeting long term expansion plans.
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In 2008, Savills hotel team, on behalf of a client, acquired a serviced apartment building in Central London for circa £100m. Savills have also been recently retained by Max Hotels as their UK agent.

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