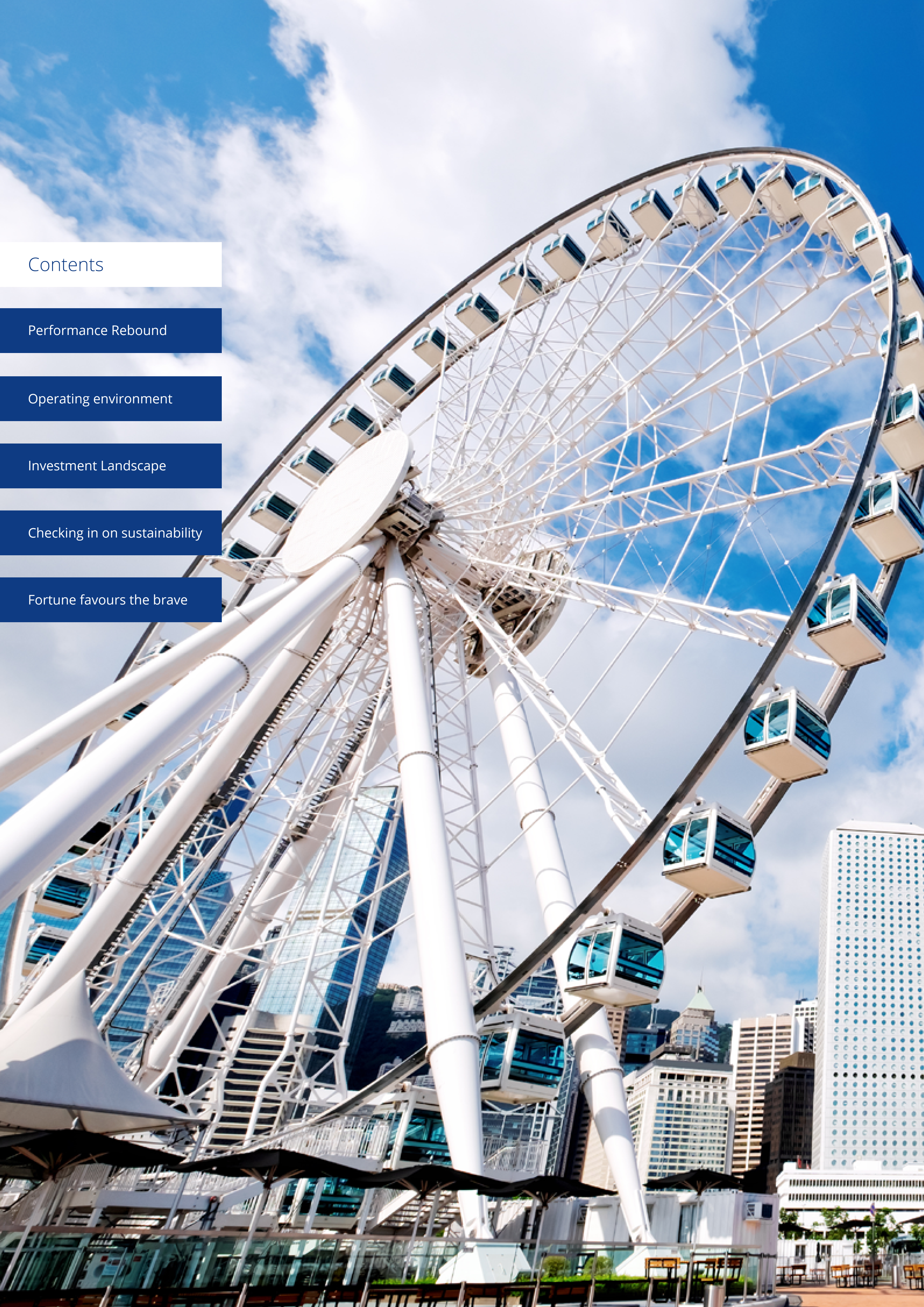
Hotels & Leisure | Hong Kong

Hospitality Insights

June 2023

Accelerating success.



Contents

Performance Rebound

With its borders reopened to the Mainland and international travel restrictions removed, the Hong Kong SAR is fast out of the blocks this year. Many of the city's hotels have seen significant improvement over their 2022 performance, including a boost in occupancy and daily rates in the first quarter of 2023. A select few have even seen their performance surpass pre-pandemic levels, leading up to the highs experienced over the "golden week" holiday in May.

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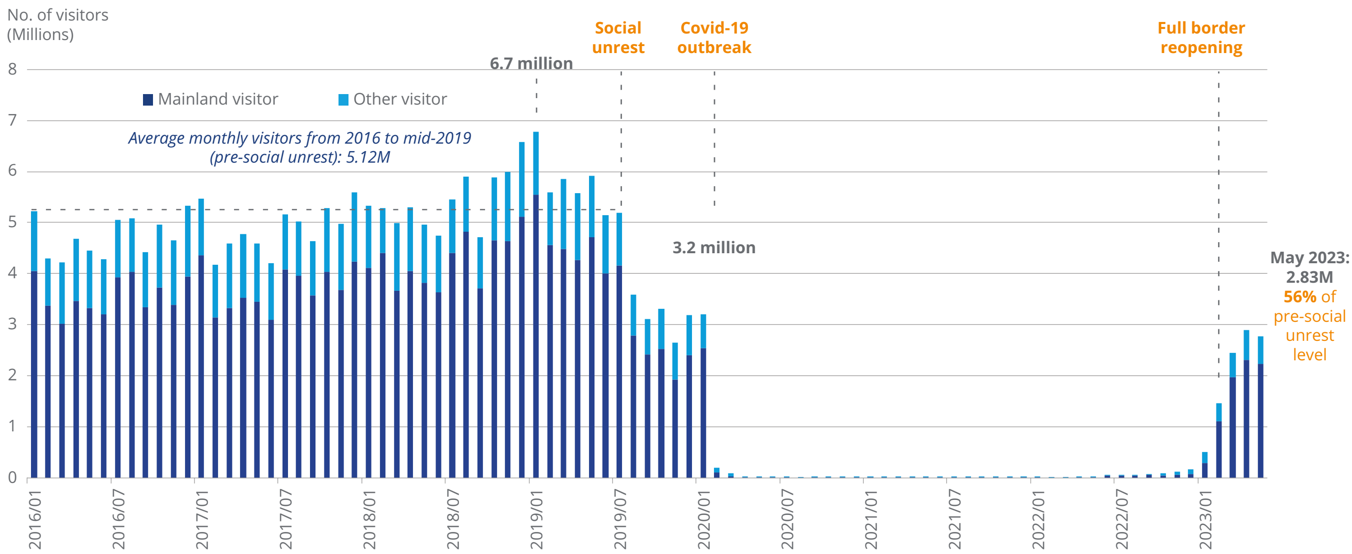
Rebounding inbound travel boosts performance

There is reason to be optimistic about the year ahead. The city has seen an influx of visitors, thanks to major events and festivals like Lunar New Year, Clockenflap, the Hong Kong Rugby Sevens, Creamfields, Art Basel and China's Labour Day Golden Week, as well as a host of conferences, exhibitions and business gatherings including the Asian Investor's Family Office Briefing. With more events planned for the year, we should expect more inbound travelers to Hong Kong.

According to the Hong Kong Tourism Board, the city received 4,414,751 visitors in the first quarter of 2023. Of these, 2,340,735 were overnight visitors, with 71.4% from the Mainland, and 28.6% from overseas. While these numbers are still significantly lower than those from the same period in 2019 – over 18 million visitors of which 7.75 million were overnight visitors, they still gave the hotel sector a positive boost, especially as we edged into March and beyond. Visitor arrivals in April and May were around 2.8 million for each month with overnight visitors accounting for just over 50% of the total.

Visitors surged after border reopening

Visitor Arrivals | Jan 2016 - May 2023



Source: Colliers, Hong Kong Tourism Board, Immigration Department
** Mar 2023 figure from Immigration Department, other figures from Hong Kong Tourism Board (HKTB). Although the methodology of counting visitors is slightly different between HKTB and Immigration Department, generally the monthly difference is less than 2,000 pax and therefore we can still take reference from Immigration Department.*

Full recovery will take time

The city's signature dynamic vibe is coming back, providing much needed impetus for the hospitality sector. However, more work is needed, and bringing Hong Kong's hotel sector back to its 2018, pre-pandemic vigour may be a gradual process. Airline traffic will likely take at least 12 to 18 months to reach capacity, and staffing shortages will continue to keep the city's airport and some hotels from operating at maximum levels. While hoteliers have adapted to be more efficient, operating costs are also expected to play catch-up with the increasing hotel revenues in the coming months. Geo-political pressures, inflation and interest rates continue to cause uncertainties on a macro-level, keeping the overall hospitality landscape positive yet cautious.

Trends & Highlights 2023

- Border reopening
- Increased inbound travel
- Return of major events
- Improved hotel performance
- Return of F&B and banquet business
- Private capital for offloaded assets
- Joint-ventures
- Increasing investment appetite for hotels and multi-family properties
- ESG and green financing
- Labour shortages
- Limited airline capacity

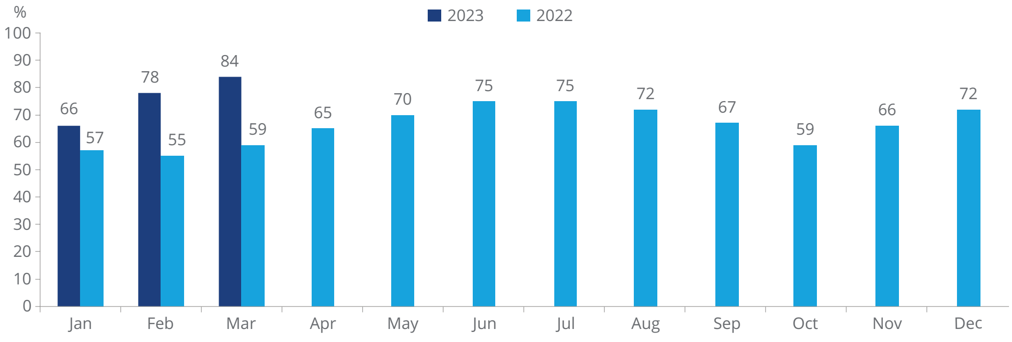
Operating environment

Q1 2023 Performance Overview

The renewed energy in the city's tourism industry continues to be felt in the hotel sector, with supply, performance, and operational numbers recording an upward trend since January 2023.

Year-on-year average hotel occupancies (OCC) were up 16% to 66% in January, up 41% to 78% in February, and up 42% to 84% in March, ending the first quarter with an average occupancy of 76%, up 33% against the Q1 2022 figure of 57%.

Average Hotel Room Occupancy Rate for All Hotel | 2022 - Mar 2023



Source: Hong Kong Tourism Board.

Average Achieved Hotel Room Rate for All Hotels | 2022 - Mar 2023

^ Provisional figures, subject to revision later on as more data becomes available.
Source: Hong Kong Tourism Board.

Over the same period, average daily rates (ADR) also jumped by 12.4% to HKD 1,048 in January; 18.5% to HKD 1,162 in February; and 30% to HKD 1,393 in March, with the year-on-year average daily rate over the quarter up by 21% to HKD 1,201.

As the key perfomance indicator, Q1 2023 Revenue Per Available Room (RevPAR) was HKD 910, up 57% from HKD 566.

A deeper dive across the different category hotels for the quarter provides further insight. Luxury hotels (High Tariff A) averaged HKD 2,068 per night with occupancy up from the previous year's 42% to 71%. These luxury operators, in particular, saw their rates surge over major events, such as during Art Basel week (23-24 March 2023), to between HKD 8,000 to HKD 10,000 per night, helping drive performance. Upscale hotels (High Tariff B) were at HKD 923, with occupancy up to 80% from 64%. And while occupancies for midscale hotels (Medium Tariff) were at 75%, up from 59% in Q1 2022, their average rate per night was down 6.1% over the previous year, at only HKD 610 per night for Q1 2023. This can partially be attributed to certain hotels transitioning out of the quarantine hotel scheme back to their normal hotel business following the removal of COVID restrictions in Hong Kong. The improved performance has been coupled with an increase in non-room revenue from F&B, banquets, events and weddings, although perhaps at a lower level than expected.

Q1 2023 Performance Snapshot

OCC: 76%
Up 33% from Q1 2022

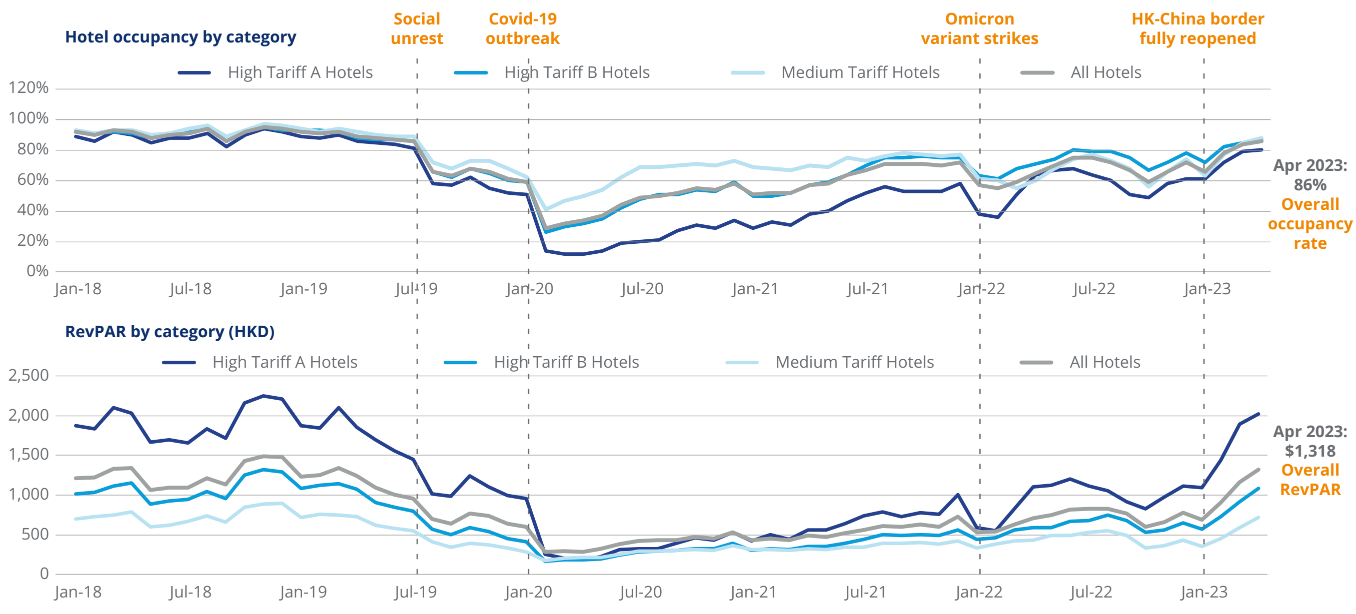
ADR: HKD 1,201
Up 21% from Q1 2022

RevPAR: HKD 910
Up 57% from Q1 2022

Beyond Q1 2023

In summary, January and early February ramped up nicely, albeit not as fast as expected for some operators. Mid-February and March performance rose sharply to new post-pandemic highs, with many operators up in the 80-90% occupancy range. While the Easter Weekend boost was less apparent, as many people traveled out of the city, the overall April figures showed occupancy and average rates hitting 86% and HKD 1,532 respectively. The May "golden week" holiday saw rates pop over the weekend, with some hotels achieving almost two to four times their normal rate. The focus is now on the hotel sector's ability to maintain the momentum and seeing where this will take us for the rest of the year.

Occupancy / RevPAR surpassed H2 2019 level after border reopening

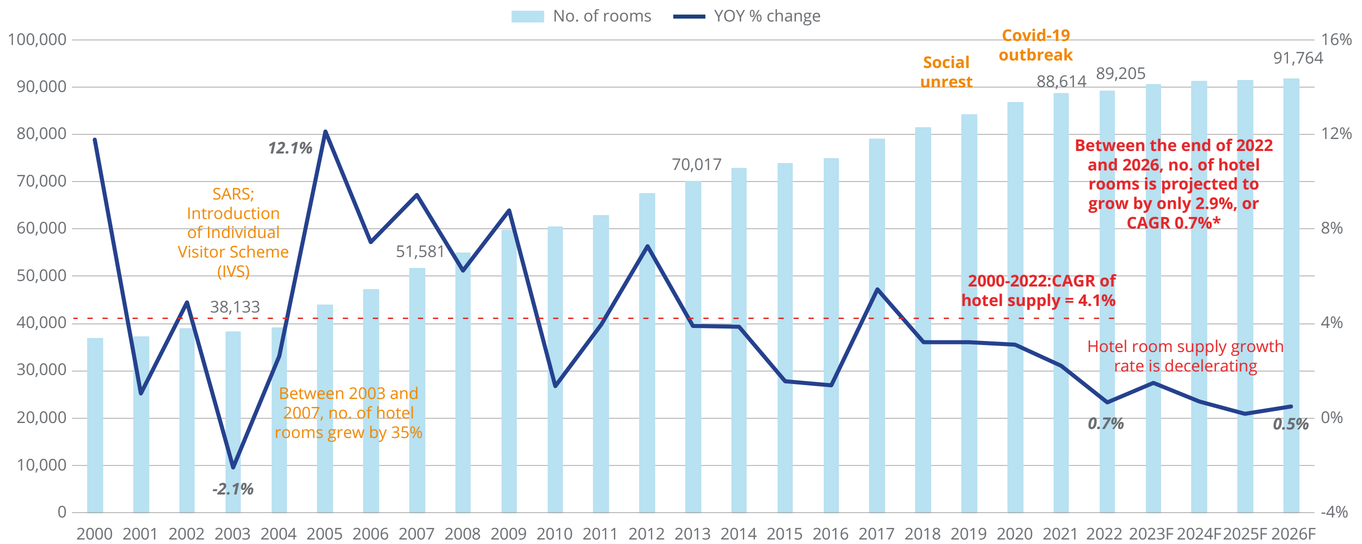


Source: Colliers, Hong Kong Tourism Board

As of 31 March 2023, Hong Kong has 319 hotels with 89,254 keys, with at least four more notable hotels expected to come onstream this year and beyond. These include the Regent (currently under soft-opening), The Kimpton, The Urbanwood and Hopewell Centre II. The City also has 1,347 guesthouses with 11,438 rooms, down from 1,520 guesthouses and 12,702 rooms in 2019.

Limited future supply underpin hotel sector as border reopened

Total hotel stocks



Source: Colliers, Hong Kong Tourism Board

** Future supply figure doesn't cover other hotel projects without specific information on planned completion date, which consists of 5,778 rooms / 25 hotels. However, even assuming those projects will be all completed by 2026, the no. of hotel room growth is only 9.3% (or CAGR 2.3%) from the end of 2022 to 2026.*

Operating Highlights 2023

- Border reopening and travel returning
- Increasing OCC, ADR and RevPAR
- Increase in non-room revenue from F&B and banquets
- Major business, art, cultural, and sporting events coming back to the city
- 'Hello Hong Kong' campaign launch
- Labour shortages and limited airline/airport capacity

Investment Landscape

Hong Kong's hotel sector has had two notable deals completed in Q1 2023: the sale of the 695-key Penta Hotel in San Po Kong at HKD 2 billion, a deal which was announced at the end of 2022, and the sale of the 546-key Kimberley Hotel in Tsim Sha Tsui at HKD 3.4 billion, originally acquired in 2019 for HKD 4.3 billion, reflecting an approximately 20% price reduction.

The year is expected to continue on an upward trajectory, as investors eye the hotel sector's improving performance as an indication to step back in. However, high interest rates, buyer-seller pricing gaps and global macro-economic and geo-political headwinds are creating some uncertainty. Investment deals could potentially surpass HKD 7.5 billion. Comparatively, there were five notable hotel transactions in the past year – most of which transpired during H1 2022 – with a total investment volume of nearly HKD 6.2 billion with 1,620 transacted keys. A majority of the acquisitions were for converting existing hotels to co-living and student accommodation, and were undertaken by private equity funds including Angelo Gordon, PGIM and AEW, in conjunction with investor-operators, such as Weave Living, Dash Living, and Crystal Investment.

Selected hotel transactions between the outbreak of Covid and 2023 Q1

Date	Location	No. of rooms	Consideration (HKD)	Price per room/ unit (HKD)	Purchaser
2023/01	The Kimberley Hotel, Tsim Sha Tsui	546	3.4B	6.2M	CTG Hotels
2022/12	Penta Hotel Hong Kong Kowloon, San Po Kong	695	2B	2.9M	Angelo Gordon / Wang On
2022/05	Grand City Hotel, Sai Ying Pun	214	0.9B	4.21M	Angelo Gordon / Weave Living
2022/05	Bay Bridge Lifestyle Retreat, Tsuen Wan	435	1.42B	3.27M	Magnificent Hotel Investments
2022/04	Rosedale Hotel Kowloon, Tai Kok Tsui	435	1.38B	3.16M	PGIM / Weave Living
2022/01	Travelodge Central Hollywood Road	148	0.85B	5.7M	PGIM
2021/12	Hotel SAV, Hung Hom	388	1.65B	4.26M	AEW / Crystal Investment
2021/08	Butterfly On Prat, Tsim Sha Tsui	158	0.98B	6.2M	Hines / Mindworks

Source: Colliers
** Only deals valued HKD 100 million or above are counted.*
Serviced apartments are excluded from the figures. Highlighted transactions are hotels that converted into co-living / student accomodations

Increasing capital for hotel and multi-family sectors

With the improving hotel sentiment and performance outlook, and the increasing need for more flexible accommodation options, investors continue to look at both the hotel and multi-family residential sectors. The HKSAR Government's recent widening of its talent attraction schemes are likely to strengthen the demand for these alternative accommodations. A lack of professionally managed flexible accommodation solutions in the private sector presents investors with an opportunity. Furthermore, a number of new hotel operators are looking to enter the market to create a differentiated experience, and partnering with the right capital will be key to their success.

Challenges

1. Interest rate uncertainties
2. Some 'stress' entering the market
3. Improving performance but higher debt service
4. Limited but improving access to bank financing
5. Underwriting challenges

Opportunities

1. Potential sale of certain hotels present investors and operators with a chance to enter market
2. Possible pricing dislocation
3. Align ESG and green financing initiatives
4. Target hotels and multifamily assets
5. Maximize opportunities driven by talent and business attraction schemes

Surging interest rates bring both uncertainties and opportunities

The pace of increasing interest rates has and will drive certain owners to offload some assets, providing cashed-up investors an opportunity to acquire hotels now and possibly refinance later. As these interest rate hikes and their potential stabilization gain clearer visibility, investors will be able to take a more calculated view on their underwriting. Until then, we have a market with two faces: one buoyed by improving operational figures and performance, and another hindered by high interest rates and limited but improving access to financing. While banks in Hong Kong are starting to open the taps for this sector, it is really the private capital and family offices that stand well-poised to potentially play in this space.

While those investors with cash and liquidity may acquire strategically, joint-ventures are likely to be the preferred avenue as investors and operators look to mitigate risk.

Investment Trends 2023

- Private capital looking for 'stressed' opportunities
- Joint ventures to mitigate risk
- Increased appetite for pure hotels and multi-family assets
- ESG and green financing

Checking in on sustainability

ESG has been an increasingly important topic in the hospitality sector. With real estate, particularly hotels, being a major source of carbon emissions, a number of hotel groups in Hong Kong are making concerted efforts towards greener operations, looking beyond energy savings to deeply understand the wider sustainability challenges ahead.

Buildings account for over 90% of Hong Kong's total electricity consumption, and over 60% of the city's total carbon emissions can be attributed to this consumption. With currently 319 hotels, Hong Kong's hospitality sector has an important role to play in decarbonizing the city. But while the Government's "Climate Action Plan 2050" provides hotel operators with targets to enhance energy efficiency in their buildings, and building certification providers are expanding their sustainability assessment standards, the sector might need more incentives to actively pursue retro-commissioning initiatives.

There is also growing pressure to "go green" from hospitality guests. Booking.com's latest travel research reports that 76% of people (up from 71% in 2022 and 61% in 2021) wish to travel more sustainably over the next 12 months – a sentiment that will once again require hotels to make sweeping changes in their operations, if they haven't already.

As the sector works to make a positive impact on stakeholders at all levels, particularly employees and the local communities, we can expect to see more initiatives come to the fore. Investors, owners and operators are more aware of 'green washing' and 'green hushing' as they strive to make a tangible difference. Banks, also growing more mindful of their part in the ESG picture, may be more inclined to lend and support these hotels under various green financing schemes.

Highlights 2023

1. The hospitality sector is more aware of its responsibility towards the environment and the wider society.

2. There is a need to adopt energy efficient solutions and assess supply chains to facilitate decarbonization.

3. Research shows that more travelers are prioritising sustainability.

4. The ESG conversation is resonating across industries, including banks, making the likelihood of green financing options for hotels more plausible.

Fortune favours the brave

Hong Kong remains a key city linking the Mainland with Asia and the rest of the world, and vice-versa.

With inbound travel and airline capacity expected to improve over the year to nearly 80% of pre-pandemic levels, and with an influx of major international events, Hong Kong's hotel sector is also expected to continue performing strongly in 2023.

Ample capital resides in the city, and while rising interest rates have become a source of uncertainty, investors will gradually gain clarity on where pricing might settle.

Moreover, the Government is working hard to build a framework for attracting more family offices, private wealth, funds and I&T (Innovation and Technology) industries. It is also creating a more regulated environment to entice blockchain, web3 and crypto companies to be based here. More sports, adventure and art tourists are expected to swarm the city, with Hong Kong's amazing natural parks, hiking trails, and vibrant art scene all beginning to open up to the world.

The knock-on effects from these business and leisure developments, as well as the city's increasing links with the Greater Bay Area, should bode well for the hotel and wider hospitality sector.

There is still a lot of work to be done to recoup the damage inflicted by the pandemic over the last three years, but the window of opportunity for operators and investors is now more apparent.

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