

## EXECUTIVE SUMMARY

### SCOPE OF WORK

PKF Consulting Limited (PKFCL) was engaged by the Federation of Hong Kong Hotel Owners Limited (Federation) to conduct a critical analysis of the state of the hotel market in Hong Kong. In light of the unique dynamics of the overall Hong Kong economy, as well as its property and hotel markets in recent times, hoteliers are facing a period of increased economic and political uncertainty as the territory approaches its 1997 reversion to China. Furthermore, the future supply of hotels is expected to be highly dependent on variations in underlying property values, as evidenced by the recent surge of hotel redevelopment activity. As the hotel market progresses into this period of transition, and given that the Federation members must prepare for future changes, the Federation commissioned PKFCL to independently assess the numerous variables which affect the industry, and to examine the future supply and demand characteristics of the market.

This study addresses the following areas:

- to review the economic environment in Hong Kong in relation to the hotel industry;
- to review the tourism industry in Hong Kong and its impact on the hotel sector;
- to review the historical and projected market performance of the hotel industry at four quality levels;
- to review the support for the hotel and tourism sector in major markets world-wide;
- to examine the occupancy and rate performance of Hong Kong in relation to other major markets;
- to examine the land use policy effecting hotel owners/developers in other major markets;
- to review the issues affecting hotel versus commercial investment in Hong Kong;
- to gain input from various industry sectors on their views of the hotel industry in Hong Kong;
- to determine the most appropriate rate of new supply growth in the market; and,
- to make recommendations relating to more effective hotel industry - government dialogue.

Our work programme for this assignment included the following:

- a review of our in-house database on Hong Kong and specifically on the hotel and tourism industry;
- a review of our PKF worldwide database in order to examine the competitiveness of the Hong Kong hotel industry in relation to other worldwide gateway destinations in terms of average room rate, occupancy levels, government support, regulations governing the hotel industry, government incentives, hotel/government dialogue;
- interviews with government officials in major gateway cities to determine the land use zoning in regulations affecting hotel development;
- interviews with representatives from the hotel industry, local companies and demand generators in order to assess the potential demand for hotel accommodation and gain insight into the future market variables such as supply, demand, pricing and market position, based on the informed opinions and expectations of industry professionals.

Our analysis, findings and recommendations are presented in the following sections.

**SUMMARY FINDINGS AND IMPLICATIONS**

**Finding 1:**

**Pattern and mix of guest room consumption is not directly proportional to visitor arrivals.**

Though there is a strong correlation between visitor arrivals and hotel occupancy in Hong Kong, there have been several instances historically where visitor arrivals have increased while hotel room occupancy has declined. One reason for this phenomenon is the fact that a large number of visitors from China do not stay in hotels. Many visitors stay with relatives in Hong Kong, guesthouses or even dormitories. Statistics in 1992 and 1993 show that the average length of stay in Hong Kong has increased. (In 1993 China visitors began to be included in the statistics). However, this differs from statistics reported by hotel operators who claim that their average stay has been declining in the past two years. This contradiction indicates that one must be careful not to rely solely on visitor arrival projections in determining future hotel market performance.

***Implication:***

**Careful and in-depth study is required before any correlation of cause and effect can be concluded.**

**Finding 2:**

**Room shortage in Hong Kong is primarily seasonal.**

Survey respondents indicated that difficulties in obtaining room bookings was seasonal. They were generally satisfied with their ability to obtain bookings. 72 percent of corporate respondents reported that they required less than one week advance notice to secure a room booking at their preferred hotel. Though the occupancy rate in Hong Kong was 86.2 percent, one of the highest worldwide, the Hong Kong hotel market is generally constrained over the September to November period only. This is due primarily to an uneven distribution of major events over the course of each year.

***Implications:***

The room shortage is not as critical a problem for Hong Kong when viewed on a full year basis. We forecast that there is greater demand for medium tariff hotels in the near and long term.

**Finding 3:**

**Room rates in Hong Kong are moderate when compared to most gateway cities.**

Hong Kong still ranks behind markets such as Paris, Tokyo, London, Osaka, Taipei and Frankfurt in terms of its average daily room rate. In fact, room rates in Hong Kong suffered a four-year period of depression over the 1988 to 1993 period and full recovery did not occur until late 1993.

*Implication:*

**Hotels in Hong Kong are price competitive and should not be constrained from attracting more visitors in the future.**

**Finding 4:**

**Hong Kong companies are becoming more proficient in hotel management.**

Research shows that in 1994 there are approximately 10 international hotel chains owned by Hong Kong companies which provide over 100,000 hotel rooms worldwide. It shows that Hong Kong hotel professionals are becoming much more proficient in this field and are exporting management services overseas.

*Implication:*

**The hotel industry in Hong Kong is a separate and sophisticated market, not simply part of the tourism industry or property market as traditionally viewed by Government and the public.**

**Finding 5:**

**Hotel operating costs in Hong Kong are relatively high.**

Hong Kong hotels generally have higher staff per room ratios than other markets worldwide. Combined with high labour costs, hotel operating costs per square foot can be more than double that of an office building. Between 1989 and 1994, labour costs increased steadily in the hotel sector showing a 55.6 percent increment.

*Implication:*

**Government should consider a higher labour import quota for hotels in the general labour quota scheme.**

**Finding 6:**

**Hong Kong is one of the only markets in the Asia/Pacific region which has a different plot ratio for hotel (lower than office) versus commercial/office use.**

Based on a comparison of hotel versus office redevelopment values, the residual value attributed to the land based on project value less development costs for a hotel is 1/5 of an office building, assuming equal net site areas. The average hotel land cost/square foot of net floor area is approximately 48 percent higher than that for an office building based on current market conditions.

*Implication:*

**Hotel investment is less attractive than other commercial investments as operating and development costs are high.**

**Finding 7:**

**Research shows that the number of hotel rooms in Hong Kong should be increased by approximately 14,000 over the next ten years.**

At the present time there are 24 hotel sites which have been planned to accommodate potential additions to the Hong Kong hotel market. In conducting our analysis, we undertook two scenarios, one which included only known possible additions to supply and one which included several hypothetical properties. Based on our analysis, the supply of rooms could increase by between 13,727 and 22,127 as indicated in Table 12 and 13. However the resultant occupancies in Scenario Two are approximately 5 percentage points lower than Scenario One classifications. As the hotel markets worldwide are cyclical and subject to many external impacts, we recommend that over the period 1995 to 2004 an increase in supply of approximately 14,000 rooms would be sufficient to meet the potential increases in demand, providing the market with strong occupancy levels throughout the year assuming that the market grows as projected and that there are no negative external impacts affecting the hotel market performance over the term of our projections.

***Implication:***

**Additional strategically provided hotel sites are required to meet the potential demand over the next ten years.**

**Finding 8:**

The Hotel Ordinance, originally drafted for the regulation of guest houses, is being imposed on purpose-built hotels whose management and safety standards are significantly higher and based on international norms.

***Implication:***

**Current unfavourable license renewal requirements should be reconsidered.**

**Finding 9:**

License fees for hotels have increased by approximately 10 times in 1994.

***Implication:***

**Purpose-built hotels are likely subsidising the costs associated with the licensing of guest houses.**

**Finding 10:**

Increased dialogue between hotel owners and government is of critical importance in setting policy affecting hotel operational and land use issues in Hong Kong. This can only be accomplished through a mandated forum for discussion. As indicated in our research, many other jurisdictions worldwide have greater hotel industry/government dialogue affecting policy matters.

**PRIMARY RECOMMENDATIONS AND ACTIONS**

Based upon our research programme and the resulting conclusions relating to the Hong Kong hotel industry, we have developed our primary recommendations and suggested actions to be dealt with in the short term. These are as follows:

<b>Table 1</b>	
<b>Short Term Recommendations and Actions</b>	
<u>Recommendations</u>	<u>Actions</u>
1. It is estimated that the Hong Kong hotel market will require the addition of approximately 14,000 new rooms over the next ten years. This is a recommended amount rather than a more substantial increase, as the hotel market is cyclical and we recommend that a more conservative approach to supply additions be adopted.	1. Government should review land use policy to encourage the financially viable development of hotels in strategic locations through hotel use zoning.
2. The plot ratio for hotel and office development should be equalised in order to make hotel development more financially viable.	2. Government should immediately initiate a change in the allowable plot ratio for hotel development in line with office use. However, policy changes should not affect existing properties on a retro-active basis.
3. Strategically located development sites should be designated for hotel use only.	3. Government should immediately examine and begin to inventory potential sites suitable for hotel use.
4. A Hotel Industry Advisory Board should be established representing hotel owners and appropriate government representatives.	4. The Owners Federation should immediately draft a proposed Advisory Board Plan for submission to Government.
5. Due to the current absence of sufficient financial returns for hotel development and operation and the fact that plot ratio increases may not be enough to make hotel development viable in comparison to office use, tax reduction incentives should be considered for new hotel developments.	5. Government should consider the potential of providing tax holidays for appropriate periods for hotel developments if the option of hotel zoned sites is dismissed. This should be explored in consultation with hotel owners/developers.
6. Hotel and Guesthouse Accommodation Ordinance should be reviewed by CNTA.	6. Government should reconsider the stringent requirements for purposely-built hotels.
7. Relax some of the existing constraints for hotel development and investment.	7. Government should allow a more generous foreign labour importation quota for the hotel sector and eliminate swinging increases in hotel licence fees, as an example.
8. Enhance Hong Kong as an attractive tourist and business hub.	8. As the growth in the hotel industry must align with future economic development, the government should render sufficient support and assistance to strengthen the tourist industry in Hong Kong by exploring further tourist attractions such as golf courses and theme parks and other events that will provide greater activities for visitors and potentially increase the length of stay.

Source: PKF Consulting Limited