JLL | Achieve Ambitions

Bridging the housing gap

Is co-living an affordable alternative for Hong Kong's millennials?

What is co-living?

Co-living can be best described as a modern form of shared housing, where residents have common interests and ideologies. Most operators highlight the 'community' aspects of their schemes, which may range from yoga classes, film screenings, meals and free drinks, all the way through to networking events with guest speakers and workshops tailored to the specific interests of residents. For many, it is the shared space that differentiates co-living schemes from other types of rental housing such as studio flats and serviced apartments.

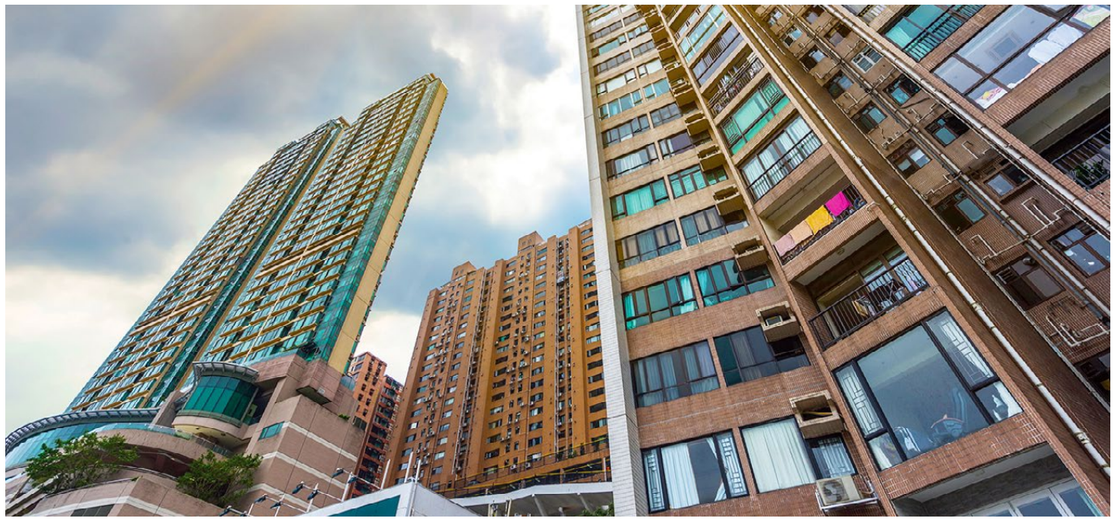
In Hong Kong, co-living is an affordable housing option, providing an alternative for those who would otherwise need to live in the family home, share a rental unit or reside in the city's notorious subdivided flats. While not explicitly stated, most co-living schemes target younger tenants who are able to contribute to the development of a like-minded community.

Who could benefit?

In our opinion, there are two key user groups that would be receptive to co-living arrangements: young professionals and students.

In recent years, the squeeze on the local housing market has been most apparent among the city's young professionals. We define young professionals as those who have completed 'post secondary-degree' studies within the past three years and whose salaries have not increased significantly during the period—hence their need for affordable housing.

Over the past three years, Hong Kong's local universities have produced about 65,000 graduates (from full-time undergraduate and postgraduate programmes). Eliminating the number of graduates who went on to further study, we estimate that there are currently 58,500 young professionals living in the city, equivalent to 0.8% of the population[1].



Quantifying demand from students is significantly harder. Using data on full-time postgraduate students provided by the University Grants Committee, we estimate there are around 8,750 postgraduate students. In addition, there are approximately 95,000 full-time undergraduate students in the eight universities in Hong Kong. These institutions only provide around 36,000 places in student residences.

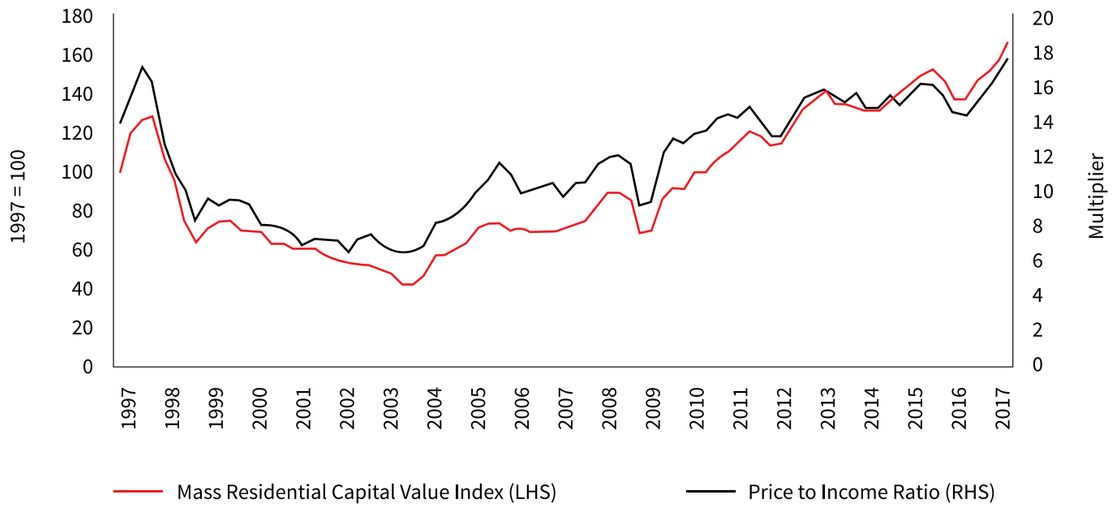
This means that about 68,000 undergraduate and postgraduate students either live at home or need to meet their housing needs in the private rental market. While it is difficult to make estimates on these high level numbers, even 10% of this student population represents significant demand.

Addressing affordability issues

Hong Kong's exorbitantly expensive housing market—which at a price-to-income ratio over 18, ranks as the world's least affordable (Figure 1)—has been well documented. Yet the situation is only likely to get worse for those who have been struggling to get on the housing ladder.

In our recent paper '**Up, Up and Away: The Rise and Rise of Hong Kong's Residential Market**', we estimated that the current cycle would last for at least a further two and half years and that prices could still increase at least another 15%.

Figure 1: Housing Prices vs. Affordability



Source : JLL

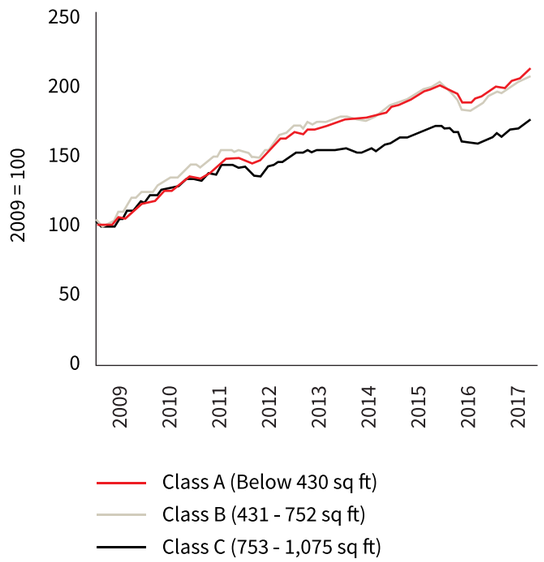
[1] Calculation based on Graduates of UGC-funded Programmes, 2013/14, 2014/15 and 2015/16, University Grants Committee; Hong Kong population as at end-2016, Census and Statistics Department

15%
Additional increase in house prices by end 2019

Those locked out of the housing market and unable or unwilling to stay within the family home typically turn to the rental market. Yet, as with housing prices, the cost of rental properties has been rising.

From the depths of the Global Financial Crisis through to the middle of 2017, the average monthly rent for properties less than 1,076 sq ft (100 sqm) effectively doubled (Class A, B and C combined), with tenants in smaller units faring even worse (Figure 2).

Figure 2: Private Rental Market – Mass Residential



Source : Rating & Valuation Department

Today, the cost of renting a studio apartment starts as low as HKD 5,200 per month, but can be as high as HKD 18,000 per month in more centralised locations.

Sharing an apartment with others is only marginally better at about HKD 5,000 per month per person in the cheapest areas. The most affordable option for those with even lower budgets is a subdivided flat, which can be rented for as little as HKD 2,000 per month, with more spacious and licensed units costing up to HKD 6,000 per month.

Subdivided flats – the no-choice option

Subdivided flats refer to single units subdivided into multiple self-contained rooms. Most subdivided flats are found in old tenement buildings in the city's older districts, such as Sham Shui Po, Cheung Sha Wan and To Kwa Wan.

According to the Census and Statistics Department, there were nearly 200,000 people living in some 88,000 subdivided flats in 2015, the most recent year for which the government has compiled this data. The median floor space apportioned to each individual was just 48 sq ft.[2]

Living conditions in subdivided flats can be appalling—a 500 sq ft dilapidated flat may be subdivided to house as many as 20 residents. Some spaces can barely fit a single-person mattress; others are cubicles stacked on top of each other. The squalid conditions and poor ventilation have led to these spaces being commonly referred to as coffin cubicles or caged homes.

Most subdivided flats are illegal and pose serious safety concerns. The buildings are usually poorly maintained and are often over 50 years old. Many have very narrow corridors and lack proper fire-resistant doors. Fire escape routes are often blocked.

Sustained demand, however, provides subdivided flat owners with little incentive to renovate. Some units may even be left to deteriorate in order to attract third-party redevelopment opportunities.

48 sq ft
Median floor space apportioned to each individual within a subdivided flat (2015)

[2] Floor space figures provided by "respondents to the best of their knowledge, excluding area shared with other households." – Housing conditions of sub-divided units in Hong Kong, March 2016

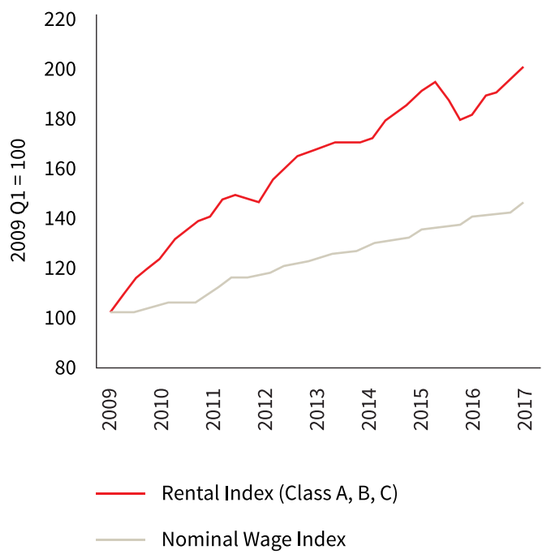
Income growth falls behind

The difficulties faced by those in the rental market have been compounded by stagnant wage growth. Between 2009 and 2017 Q2, nominal wages grew by 45%. In comparison, rentals for mass residential properties surged 102% over the same period, more than double that of nominal income (Figure 3).

Young professionals' salaries have also remained tethered. According to the 2017 Q2 General Household Survey, the median monthly income of young professionals aged 20 to 24 was HKD 13,000.[3]

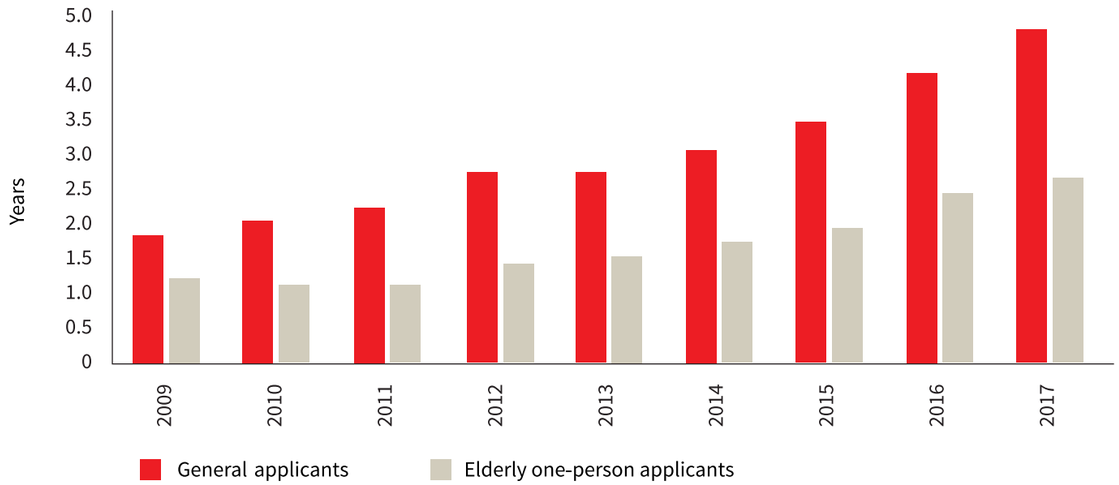
102%
Increase in rentals for mass residential properties 2009-2017 Q2

Figure 3: Income Growth vs. Rental Growth



Source: Census & Statistics Department
Rating & Valuation Department

Figure 4: Average Waiting Time for Public Rental Housing



Note: 'Average waiting time' refers to applicants who were housed in Public Rental Housing (PRH) in the past 12 months.

Source : Hong Kong Housing Authority

Public housing barely meets market needs

Hong Kong's public housing system has been able to do little to help alleviate the pressure on tenants. A 150 sq ft unit in a public housing estate can be rented for as little as HKD 770 per month[4], but this has led to fierce competition for such flats. The Hong Kong Housing Authority's latest data shows that there were around 127,600 non-elderly, single-person applications as of the end of June 2017. The average waiting time for general applicants stood at 4.7 years (Figure 4). The elderly are given higher priority than the young and those with a monthly income above HKD 11,250 are ineligible to apply for a one-person unit.

Co-living in Hong Kong

Co-living is still very much a new concept here in Hong Kong, but there are two types of distinct schemes that are already starting to emerge: those that target students and those geared towards young professionals.

The former are typically configured around shared rooms for between two to eight individuals in either twin or bunk beds. These closely resemble college dormitories and in this regard, the difference between 'co-living' and 'student housing' is only a matter of semantics. Schemes targeting young professionals, on the other hand, typically comprise small rooms (usually less than 100 sq ft) inclusive of bathroom facilities.

In both instances, rooms are usually sparsely furnished. The types of amenities provided vary between schemes. They typically include 24-hour support services, and access to common areas and cooking facilities, but can encompass gyms, swimming pools, laundry rooms, kitchens and even car parking spaces, to name just a few.

Co-living operators prefer to lease units or beds out on a monthly basis. An 'application fee' is usually inclusive of all utilities (water and electricity), a basic room cleaning service and Wi-Fi access. Other amenities often require additional payment. Renting a bed or small unit in various co-living schemes can start from as little as HKD 2,800 per month all the way through to HKD 20,000 per month, inclusive.

The type of scheme adopted by investors and operators depends largely on prevailing rental market trends. In areas where rental levels are higher, it may be more viable to operate co-living schemes designed for young professionals. Areas with lower rental levels will likely be more suited to the student housing market.

HKD 2,800
per month
Starting rental for co-living schemes

[3] Median monthly employment earnings of employed persons aged 20-24 with educational attainment of post-secondary degree, General Household Survey, 2017 Q2, Census and Statistics Department

[4] Paper No. SHC 40/2016, Hong Kong Housing Authority

Current co-living schemes in Hong Kong

	Bibliotheque	SynBOX	Mini Ocean Park Station	Campus Hong Kong	T Plus	Innocell
Operator **Location** **Opening**	Synergy Biz Mong Kok September 2017	Synergy Biz Hung Hom September 2017	Eton Properties Wong Chuk Hang August 2017	Gaw Capital Tsuen Wan 2015	Stan Group Tuen Mun 2018	Undefined Sha Tin 2020
Layout	Three 5-storey buildings	One 5-storey building	Three 3-storey buildings	One 12-storey hotel-service apartment building	One 13-storey building 3-storey shopping mall One club house 52 car parking space	One 18-storey building
No. of Rooms **No. of Beds**	15 166	15 67	270 Undefined	48 192	356 Undefined	500 Undefined
Room Size	800-1,600 sq ft	129-332 sq ft	80-200 sq ft	660 sq ft	128-387 sq ft 8 featured units: 358-753 sq ft	194 sq ft
Monthly Rent (HKD)	3,000-5,000	2,800-3,800	7,500-20,000	Bed: 5,000 Room: 20,000	4,000 and up	8,000-10,000
Services and Facilities	Cleaning service Common area Pantry/cooking facilities Wi-Fi network	Cleaning service Common area Pantry/cooking facilities Wi-Fi network Laundry room	Cleaning service Common area Laundry room Pantry/cooking facilities Wi-Fi network	Cleaning service Common area Wi-Fi network Free shuttle bus Fitness room Swimming pool	Undefined	Undefined

Source: JLL, Market Sources

Licensing Issues

One of the reasons co-living operators prefer to lease out units on a monthly basis is to skirt the city's hotel/guesthouse licensing requirements.

Under Hong Kong law, any premises that provide sleeping accommodation for a period of less than 28 consecutive days must obtain a hotel/guesthouse operating license from the government.

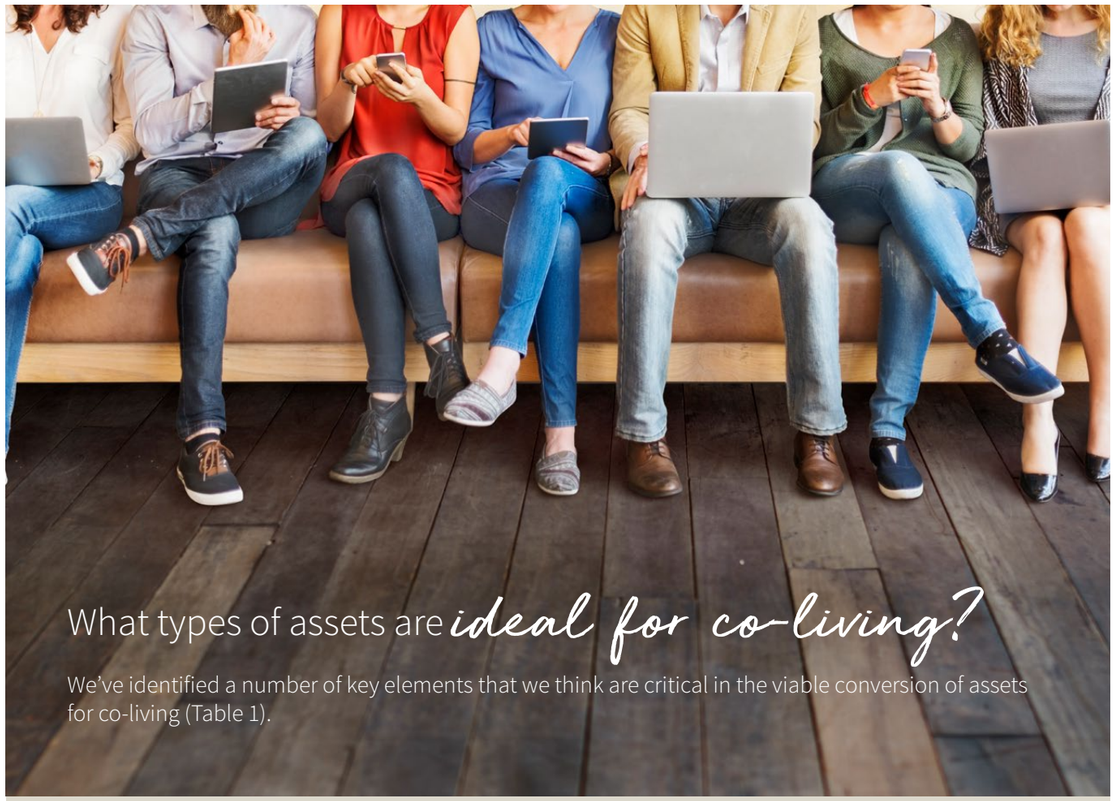
Having a hotel/guesthouse license is not a must, but it does increase the operational flexibility of a co-living scheme. The licensing application process, however, can be quite time consuming.

In cases where extensive building alteration works are required (i.e. the addition or removal of internal walls, or the installation of lifts and centralised water systems, etc.), this can take as long as two years.

For domestic building conversions where individual units contain 12 or more beds, operators must apply for a Bedspace Apartment license. The government introduced these licenses primarily to regulate safety within the subdivided flat market. As such, beds provided in these schemes cannot be rented out on a daily basis. Schemes that are not let on a daily basis and house less than 12 individuals per unit are exempt from licensing arrangements, although any alterations to the building are still subject to compliance with the Buildings Ordinance.

License Type	Licensing Authority	Restrictions
Hotel | Guesthouse	Home Affairs Department / Office of the Licensing Authority	- Properties for domestic or hotel/guesthouse use allowed - Administrative enhancement required - Daily rental allowed
Bedspace Apartment	Home Affairs Department / Office of the Licensing Authority	- Domestic properties with 12 or more beds - Minimum rental period of 28 days

Source: Office of the Licensing Authority



What types of assets are *ideal for co-living?*

We've identified a number of key elements that we think are critical in the viable conversion of assets for co-living (Table 1).

Table 1: Critical Elements for Conversion

	Criteria	Recommendations
	Building Age	The conversion of older buildings usually provides the greatest rental uplift. At first, most schemes targeted converted older tenement buildings ('tong laus') and their lift-enabled counterparts ('yeung laus'), dating from the mid-1960s-1980s. More recently, however, conversions of newer residential and hotel/guesthouse properties have also emerged.
	Ceiling Height	Higher ceilings (at least 3.5 m, or 11.5 ft) allow beds to be raised, creating extra floor space. As a result, rooms can be smaller, increasing the utilisation rate of the overall co-living scheme.
	Ownership and Ownership Structure	En-bloc properties are able to provide the scale necessary for conversion and remove issues that may arise because of a Deed of Mutual Covenant (DMC). Properties that are held and transferred via a corporate entity are preferred as this lowers investors' stamp duty tax burden considerably, from as much as 30% down to as low as 0.1%. Shared co-living areas need to account for around 10% of the scheme's total floor area.
	Land Grant	Properties on land leases granted with fewer restrictions are more attractive.
	Building Type	Residential buildings are preferable as the conversion process is more straightforward. Hotels and guesthouses with smaller rooms that require minimal alterations may also be suitable. Buildings where a change of use from non-domestic to domestic has been approved may also be feasible but will require more upfront capital for conversion works.

Source: JLL

Case Study

Noting the demand for affordable housing and co-living schemes, there is increasing interest from owners and investors of existing residential and hotel/guesthouse en-bloc properties in this sector. We analysed two conversion schemes—a hotel and a residential building—to demonstrate the investment case for co-living (Table 2). In both instances, it is apparent that an owner/investor can increase their rental yield by converting an existing hotel or residential building into co-living space.

Our analysis shows that rental income (NOI) may be improved by as much as 19.9% in the case of a residential conversion, while NOI yield can increase by 12.1% after taking into account capital expenditure for conversion and any loss of rental during renovation works. Returns can be further boosted through the use of financial leverage and operational improvements such as increasing performance accountability, streamlining maintenance processes and centralising data management.

12.1%
Potential increase in rental yield through residential conversion to co-living space

Table 2: Case Study

Scenario 1 - Hotel

	Typical Leasing Scenario (Before Conversion)	**Co-living Scenario** (After Conversion)
No. of rooms	200[1]	200[1]
Saleable area per room	120 sq ft	120 sq ft (excluding common area)
Room type	-	En-suite individual room
Common area	-	Previous hotel gym, F&B areas to be converted into common area
Room rate	HKD 400 per day[2]	HKD 10,000 per month
Net operating income (NOI)	HKD 17,520,000	HKD 20,400,000
Revenue per year	HKD 29,200,000[3]	HKD 24,000,000[3]
Operating expenses (OPEX)	HKD 11,680,000[4]	HKD 3,600,000[5]
Valuation	HKD 501,000,000[6]	HKD 538,520,000
Acquisition cost	-	HKD 501,000,000[6]
Capital expenditure for conversion	-	HKD 20,000,000[7]
Rental loss during renovation period	-	HKD 17,520,000[8]
NOI yield	3.5%	3.8%
% increase in yield	-	8.3%

Assumptions:

1. No retail on G/F
2. Average rate in Mong Kok / Yau Ma Tei
3. Based on 100% occupancy
4. 40% of total revenue including room expenses, admin, sales and marketing
5. 15% of total revenue including cleaning of common area, security, sales and marketing, event management, rates, rents and utilities
6. 3.5% yield on NOI occupied as a hotel
7. HKD 100,000/room, mainly for renovation of common area and purchase of appliances
8. 12-months renovation period

Scenario 2 - Residential Building

	Typical Leasing Scenario (Before Conversion)	**Co-living Scenario** (After Conversion)
No. of units/beds	72[1] subdivided units	160[2] beds
Saleable area	150 sq ft/unit	60 sq ft/bed (excluding common area)
Room type	-	2-3 people sharing the same room & bathroom
Common area	-	First floor to be converted into common area
Monthly rate	HKD 7,000/unit[3]	HKD 4,000/bed
Net operating income (NOI)	HKD 5,443,200	HKD 6,528,000
Revenue per year	HKD 6,048,000[4]	HKD 7,680,000[4]
Operating expenses (OPEX)	HKD 604,800[5]	HKD 1,152,000[6]
Valuation	HKD 181,440,000[7]	HKD 194,083,200
Acquisition cost	-	HKD 181,440,000[7]
Capital expenditure for conversion	-	HKD 7,200,000[8]
Rental loss during renovation period	-	HKD 5,443,200[9]
NOI yield	3.0%	3.4%
% increase in yield	-	12.1%

Assumptions:

1. No retail on G/F
2. 1/F converted into a common area, removing 20 beds
3. Average rate in Mong Kok / Yau Ma Tei
4. Based on 100% occupancy
5. 10% of total revenue, including rates, rents and utilities
6. 15% of total revenue, including cleaning of common area, security, sales & marketing, event management, rates, rents & utilities
7. 3.0% yield on NOI occupied as a hotel
8. HKD 100,000/room and no repartitioning of rooms, mainly for renovation of common area and purchase of appliances
9. 12-months renovation period

Source: JLL

Risks

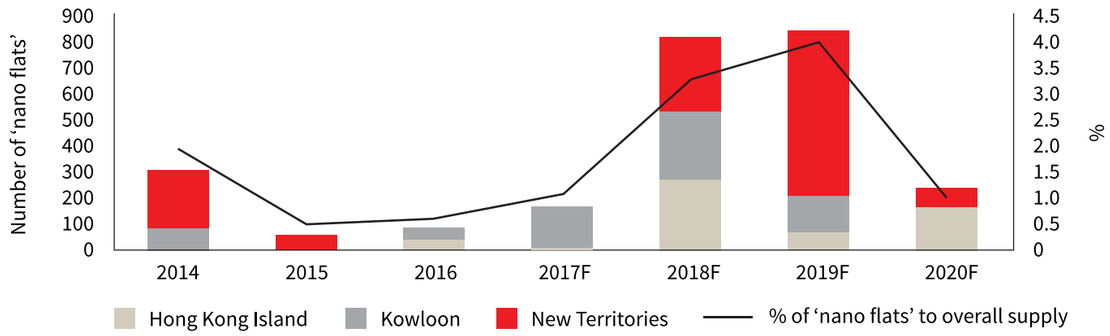
An investment in co-living is not without risks. It remains largely untested here in Hong Kong and the market could potentially face stiff competition from the rapid development of 'nano flats'.

These flats are typically less than 200 sq ft in size and those in modern developments have been selling in large numbers, given their relatively low price point. These 'nano flats' can be an attractive rental option for young professionals, given that most are less than two years old and can be rented for less than HKD 9,000 per month.

Durability and obsolescence is also another consideration. The modern fit-out and finishes provided in many new schemes are what makes them attractive to users. Whether co-living schemes can maintain their appeal after several years of general wear and tear is unknown and will depend on how much operators invest in upkeep and maintenance.

Lastly, investors need to weigh up the risks associated with short-term tenancies. While our analysis shows that co-living schemes can produce higher returns, the results assume full occupancy. These risks may potentially have an impact on an investor's cash flows.

Figure 5: 'Nano Flat' Supply



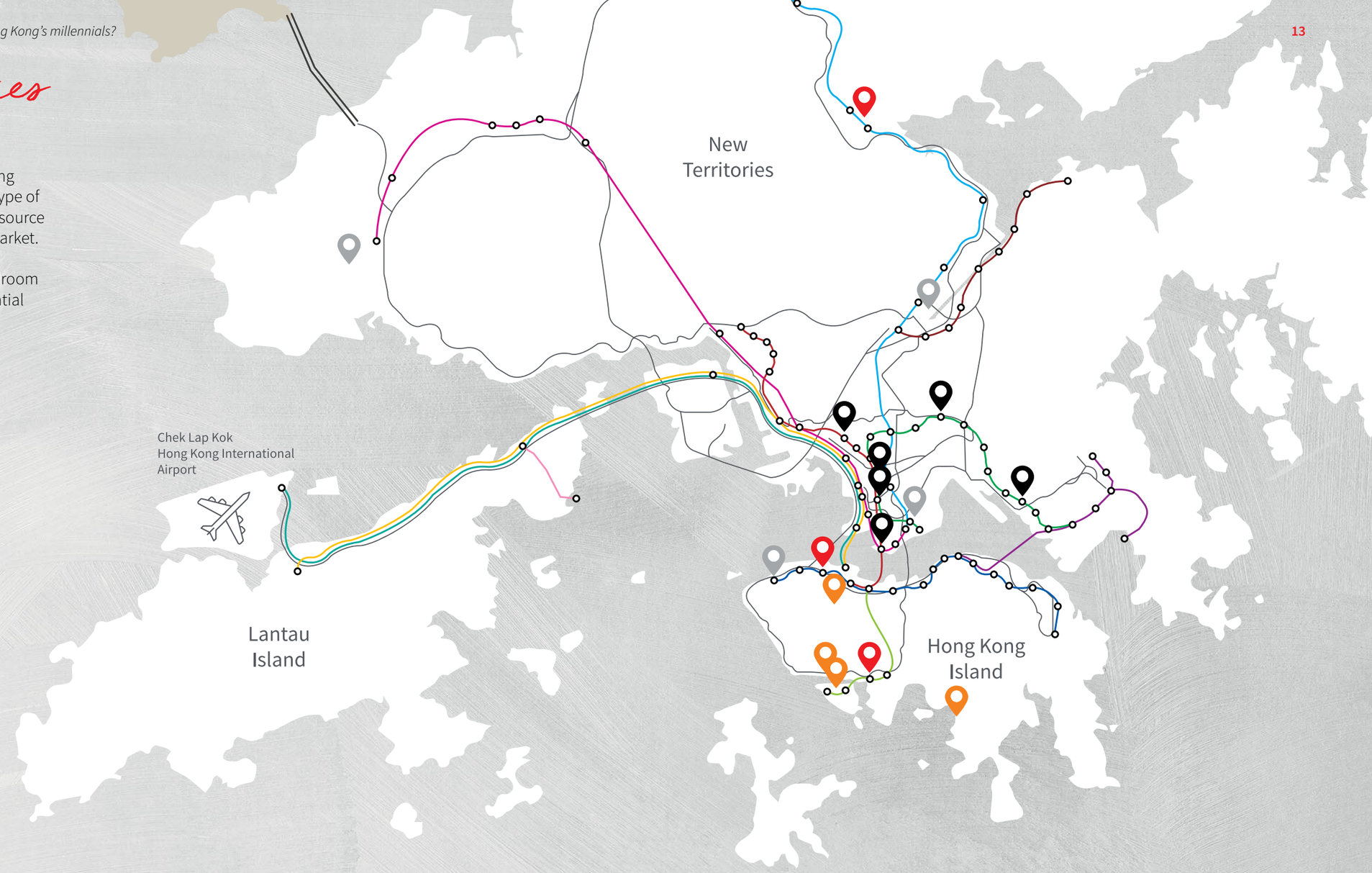
Source: Buildings Department, Lands Department, SRPE, Market Sources, JLL

Note: 'Nano flat' refers to units smaller than 200 sq ft, saleable. Estimations are made according to best available information.

Mapping Opportunities

Hong Kong's relatively small city footprint means that co-living schemes can be established in almost any location. Yet the type of scheme that is likely to be successful will depend on the key source of demand and prevailing rents in the surrounding private market.

By analysing the rental markets for studio apartments, 2-bedroom apartments, and even subdivided flats, we've mapped potential opportunities across the city by schemes (based on key user groups) and districts.



Existing Network

- Airport Express
- Disneyland Resort Line
- East Rail Line
- Island Line
- Kwun Tong Line
- Ma On Shan Line
- South Island Line
- Tsuen Wan Line
- Tsueng Kwan O Line
- Tung Chung Line
- West Rail Line
- Major Roads
- Hong Kong-Shenzhen Western Corridor

Traditional residential clusters

Kwun Tong | Yau Tsim Mong | Wong Tai Sin
Sham Shui Po | Kowloon City

The city's five most densely populated districts are all situated in Kowloon. These districts have mature residential communities with developed public amenities, transport infrastructure and shopping and dining facilities.

New economy and creative industries

Tai Po | Sheung Wan
Wong Chuk Hang

Young entrepreneurs, designers, artists and media professionals have been at the forefront of embracing the move towards working and living environments with a focus on collaboration and community.

Neighbourhoods close to higher education institutions

Sha Tin | Kennedy Town
Tuen Mun | Hung Hom

With limited student accommodation available on campus, affordable housing that is within an easy and convenient commute to Hong Kong's universities is always in demand. University students are usually more cost sensitive but may be less concerned about privacy and more willing to embrace shared rooms.

Upmarket residential areas

Mid-Levels West | Island South

Upmarket residential areas such as Mid-levels and Hong Kong South are appealing to young professionals and expats who want to live in an affluent neighbourhood without paying up-market rents.

	Traditional residential clusters	New economy and creative industries	Neighbourhoods close to higher education institutions	Upmarket residential areas
Monthly Rental Range	**HKD 5,000 - HKD 10,000** per person	**HKD 3,000 - HKD 10,000** per person	**HKD 3,000 - HKD 10,000** per person	**HKD 8,000 - HKD 20,000** per person

Conclusion

Hong Kong's housing affordability issues are putting immense strain on occupiers. Among those most affected are students and young professionals, who are unable to get on the housing ladder or access public rental housing. A look at the underlying market drivers suggests that conditions are unlikely to improve over the short-term.

In this sense, the arrival of co-living provides a new way of addressing these issues. Importantly, it offers those locked out of the housing market an affordable solution to meet their housing needs. The community aspects touted by most co-living schemes also have the potential to improve the overall well-being of residents. At the same time, co-living creates new and exciting investment opportunities in a market segment that has often been overlooked and is typically associated with low quality housing.

Our analysis shows that owners and investors can improve rental yields by up to 12.1% if they opt to convert an existing property into a co-living scheme. Moreover, operational improvements and use of financial leverages could potentially boost returns further. Although co-living is still in its early stages in Hong Kong, we believe that if done correctly, it has the potential to flourish, especially given that the housing market still has a way to go before it reaches its peak.

Nonetheless, the segment is not without risks. The growing supply of nano flats has the potential to soak up some of the demand for co-living schemes given that the rental price points may be similar in some districts. The unique selling point for co-living may therefore boil down to not simply more affordable rents but the development of cohesive communities and the benefits of living with like-minded individuals.

Authors

Denis Ma
Head of Research
Hong Kong

T +852 2846 5135
denis.ma@ap.jll.com

Raymond Fung
Regional Director
Capital Markets
Hong Kong

T +852 2846 5181
raymond.fung@ap.jll.com

Shawn Wang
Manager
Research
Hong Kong

T +852 2846 5152
shawn.wang@ap.jll.com

Alvin Leung
Associate Director
Valuation & Advisory Services
Hong Kong

T +852 2846 5532
alvin.leung@ap.jll.com