FUTURE OF RESORT RESIDENTIAL MARKET

LOMBOK

Bill Barnett, Managing Director
C9 Hotelworks
June 2014

Asian Leisure Property Perspective

There is an intrinsic link between a rising economic development profile and the growth of leisure real estate. During the halcyon days in North America of the 1960's, rising prosperity brought about a boom in recreational activities and discretionary spending. Second homes and holiday houses were suddenly no longer only for the rich, but merged into the mainstream broader real estate marketplace. From shore to shining shore, traversing the Sun Belt, be it Miami Beach or Waikiki. Warm climates, sand swept beaches and the snowbird phenomenon become compelling drivers of demand.

Over the ensuing decades the trend caught on, from the South of Spain to the Gold Coast in Australia. Increased consumer spending power pushed the cycle skyward into high-rise projects. Though traditional full property ownership took center stage, timeshare (now known as vacation ownership) pushed the envelope towards the sweet spot mass demographic. What eventually drove both full and shared ownership in the West into a mature cycle has been the evolution of financing options. The deeper you go, the more products, and pricing points are needed along with niche consumer products.

In Asia, Phuket was at the forefront of the resort property push with the innovation of hotel managed private villas. Starting in the large 1980's and going forward Aman's Adrian Zecha and K.P. Ho of Banyan Tree were pioneers in taking upscale vacations 'out of the box'. From a top down domino-effect Thailand's leading beach destination was able to capitalize on the region's economic uptick.

Geography, with a close proximity to two of Asia's wealth honeypots – Hong Kong and Singapore was a strong contributing factor to early success. Two key characteristics at the time were that the vast majority of buyers were end users of property, either as holiday getaways or casting an eye towards 'later life' usage, and that most sales were on a cash basis to overseas buyers. There was little domestic consumption at this point in time.

On a wider regional scale during a period when the East grew up to meet the West, other island's tapped into the magic formula with South Bali and Sri Lanka's Southern coastline ranking in. Majority of products during this era were freestanding villas, or houses often developed by foreigners. The domestic institutional real estate sector's had yet to realize the longer term potential of the market and remained content to stay on the sidelines.

Starting with the mid part of the new Millennium, a dynamic shift took place in Asia's leisure property sector. Cashed up, investment buyers took center stage and speculation took hold. As land prices pushed up, the need to offer more volume geared products came into play. Condominiums, hotel branded residences, vacation ownership and mixed-use projects took the cycle not up one step but thrust the market onto the global stage.

The world as we once knew it altered states in 2008. Stress and distress came into play, foreign-led developments with limited access to debt were a major casualty and a strong build up of inventory during the golden era created for the first time a significant secondary market. In the broad sense, the once dominant overseas buyer segment flattened. Suddenly supply and demand went from friend to foe and fundamentals came unhinged.

During the time of the global financial crisis, Asia led the recovery and for the most part its real estate business model was not only able to avert disaster but propelled upwards through the surging growth of a new consumer class. In each country across South East Asia, a domestication of development and buying markets took over the lead role. In the new world order East had suddenly eclipsed the West. On the heels of this shift came the entrance of larger development entities entering the leisure sector drawn by the need to grow markets and also looking in many cases at the potential for the marrying of hotel assets to recurring income streams and pairing of residential investment oriented buyers.

What became rapidly apparent with the switch over of markets was the dissipation of foreign purchasers buying leisure investment properties, most notably high end hotel branded residences. Whereas project sale pace for properties over USD1 million for units which once saw trading levels of 1-2 transactions a month have dropped in Phuket and Bali to the point it now takes four to five months to sell a single property. Furthermore hospitality branded demand has changed over to urban settings within the past few years with developers now looking to use hotel names to 'value up' mixed-use offerings in gateway cities across Asia.

In Indonesia's premier leisure destination South Bali, over the past five years has seen its condominium hotel market emerge and take on a life of its own of near epic proportions driven by overwhelming domestic demand. In terms of segmentation, domestic Indonesian buyers have represented an estimated 80% of real estate transactions. Motivation has been two-fold with unit owner holiday usage in hospitality-led residential projected and termed guarantee return offerings driving market sales absorption. Over the past twelve months traction in these types of projects is decidedly slowing with voiced concerns about hotel oversupply and rolling back of return programs to actual performance levels. The most eminent risk that the industry is pointing to is the creation of secondary market.

Viewing the wider historical cycle from emerging to a more mature real estate sector, the key takeaway trends we see today across Asia in leisure markets is:

- High leveraging of the domestic buyer segment
- Shift of hotel branded demand from resort to urban products and locations
- Downward pressure on unit sizing and price
- Changing composition of geographic source markets
- Key tiers of sales activity at entry level and top end, with decided gap at mid-scale
- Lack of financing and ownership restrictions for foreign purchasers

LOMBOK MARKET OVERVIEW

In expanded terms Lombok's real estate storyline is still at a relatively early stage of development. Most transaction activity has historically been aimed at either greenfield sites which would emerge as hotel assets or else land banking. There has been a decided disconnect over a long-established policy of the Indonesian government to establish and implement a tourism economy to the island, and the public sector which has failed to step up to the plate and invest. During this period, land speculation raged in areas such as Sengiggi and the West facing coastline.

Despite government led master planned initiatives under BTDC (Bali Tourism Development Corporation) and LTDC (Lombok Tourism Development Corporation), these ultimately failed to take root. In the period after the Bali bombings, with tourism gearing up in South Bali, Lombok failed to capture the imagination of investors. Perhaps the biggest setback at the time was the well-publicized mega-tourism development joint venture between BTDC and a Middle-East consortium led by Dubai's Emaar Properties. In what had been planned to be a leading destination resort with international hotels, a marina and residential developments, but was hit hard by the after-effects of the GFC.

During this time, most retail property sales were on land parcel subdivision deals to individual buyers and a few foreign led developments which failed to complete. Investment sentiment was also impacted due to tension in local estate trades where resentment of local's over projects which have failed to materialize and also a speculative dynamic restrained a fundamental base marketplace.

Only within the twelve months has the property market seen light at the end of the tunnel. One of the key instigators which have spurred interest has been the sale of fifty resort managed villas at the Royal Kamuela by the Latitude 8.1 Group. Priced at levels well below the inflated levels of South Bali, most units were transacted to institutional investors. At the same time new offerings in the planning stages such as BASK Gili Meno have created positive international public relations coups overseas. As such property sentiment is on the upswing in Lombok, though the compelling question remains – "Who will the buyers be?"

LAND COST – THE SOUTH BALI CONUNDRUM

Presently land prices at South Bali have continued to push upwards by extraordinary percentages for the past three years. Some observers have pointed out time and time again that price points have reached illogical levels and yet capital inflows though domestic investment have continued unabated. Capital flight has been a trend to Bali started after the 1998 crisis, as the island has long been considered to be a safe haven.

With land prices for prime plots in Seminyak, Batu Belig and Canggu reaching USD2000-2500 a square meter and the Bukid eclipsing USD1000 a square meter it is increasingly difficult to underwrite hotel or residential offerings. It's been said that Bali has some of the tallest coconut trees in the world and despite this planning mechanisms which restricts the height of buildings, developers are pushing the envelope to drive more saleable areas simply to retain marginal profit levels.

Lombok advocates say, "Why try to continue to underwrite investment deals in South Bali at unreasonable levels, when similar land can be bought in Lombok at USD100-250 per square meter?" Yet South Bali investors counter with the inherent response "Do you think land prices will actually ever go down"?

This is the paradoxical tipping point that Lombok has reached though, given Indonesia's highly domesticated hotel and real estate sectors. "At what point or trigger will the scales shift, is contentiously the key question?"

ASIAN RESORT REAL ESTATE DEMAND GENERATORS

One of the clearest lessons learned over the past two decades in The Big Two – Phuket and Bali is that tourism paved the way for real estate. The horse that drove the cart was the destination brand created by loyal returning holiday visitors. This remains a key underlying fundamental across Asia and is often overlooked in the day and age of “property focused” developers.

In more mature markets, underlying demand generators remain key to stimulate demand. These can best be summed up as follows:

- On the upper end of the market, a well serviced marina sector is critical to inducing high-end villa buyers. Phuket currently has five marinas which are full and is now overflowing to new facilities in Krabi.

- The ability to cater to private aircraft with a quality international gateway is another integral component for the ultra villa set.

- Shifting to the broader market for overseas purchasers international heath care facilities, golf courses and high standard retail outlets enhance appeal. In larger markets educational institutions help deepen demand for primary residences.

- For international end users and retirement age property owners, long stay visa programs which are prevalent in Thailand and Malaysia are critical success factors.

- Air access is a key indicator given the large historically demonstrated markets of Hong Kong, Singapore and beyond with their appetite for resort real estate. Door to door travel time and direct flights are imperative to these prospective buyers.

- An established network of well-known real estate name brands who offer transaction, resale, management and letting services provides a level of confidence to investors.

Buyers Profile

Given the infancy of the Lombok cycle, most real estate players are still working with a moving target on profiling the buying segments. Bali as stated previously is heavily dependent on Indonesian buyers from Jakarta, Surabaya and other domestic locations. Whereas the guest profile for Lombok's hotels is fairly slanted toward markets such as Australia and other regional locations.

What is needed for the market will be a form of equilibrium and the acknowledgement that the South Bali cycle cannot be repeated given the importance Indonesian's place on using real estate holiday units which they purchase. For now Lombok has not yet established a strong enough destination brand pull.

Airlift is a key indicator for tourism as "you can't stay there if you can't get there", hence a knock on effect for the property market. Australia, Singapore, and other short haul Asian markets provide the largest catchment of buyers, yet the destination appeal of beach oriented activities is at odds with this.

One interesting outcome from our continual market research in resort real estate thought Asia is the connection between the nationality of a developer and the major purchasing segments. It's likely that the buying profile for Lombok will be connected to who are developing the products in the future.

Products and Cycles

While Asia's property markets remain addicted to steroids, Lombok's development cycle will likely be pushed from the ground up by tourism. There is little doubt that the relocation of the international gateway airport has rewritten the game plan. More important is the emergence of domestic institutional investors into the Mandalika project. Market sentiment and the realization that domestic-led developers will pave the way forward for Lombok the same way they have in Bali is an excellent reality check.

South Lombok and the intended destination resorts are long term strong demand generators for real estate. But what has to be remembered is that the Laguna Phuket mixed use project kicked off with its first hotel in 1987 and was followed by more hotels in 1991 and 1992. Only in 1993 did the first residential component appear with the Allamanda resort condominium, followed by the Sheraton Island Villas in 1995. Vacation ownership evolved as the property market in 1998 and the residential gated estate of Laguna Village only come under development in 2002. This is a full 15 year cycle to go through investment oriented properties to eventually move into a maturation process with primary residences.

One of the current compelling challenges facing property developers in South Bali is to forecast what mix of buyers will materialize in a project before the first brick of a building is land down. Legal structuring for developments either are focused on selling freehold property or units to Indonesians or else leasehold for foreign buyers. In Bali there has been a decided pull back from Indonesian's on leasehold projects and this is a complicating factor for Lombok given the unknown composition of the future buying market.

At the same time all across Asia in resorts we are again seeing a rise of hotel branded residences. These are aimed at investment oriented buyers and not end use. Again these are discretionary spends combining a highlight of recurring yields and also lifestyle usage. In the post GFC world, and shift to more Asian buyers, pricing is shrinking to the manageable levels of USD75,000 to USD200,000 band. Unit size is driven by price. One sure sign of the times has been the Banyan Tree Group's launch of a new hospitality-led residential brand Cassia which is targeting this exact same pricing band in a number of the regions resort market. Furthermore since the tightening of property restrictions we are seeing more Singaporean buyers purchase similar products overseas.

In anticipating the Lombok property cycle it's important to preposition that Lombok cannot and should not be benchmarked to Bali or Phuket. These two islands are Asia's two dominant resort destinations with decades of hotel product, support infrastructure and experience. Both are now headed into an urbanized eras that will likely transform them into cities by the sea in the next ten years.

Looking at Lombok's 2022 journey other benchmarks like Koh Samui are more relevant in the short to medium term given the boutique nature of the underlying accommodation markets, strong independent hotel offering and natural surroundings. At one point though Lombok will be able to leapfrog these smaller competitors though provided by its quality gateway airport and planned destination resort but this has to be on a longer term trajectory.

Over the next few years the real estate offering that are likely to succeed in Lombok will be hotel investment offerings for the simple fact that this is where the current market demand is at present. At the other end of the scale the affordable land pricing component will see more end user buyers for holiday homes or as rentals to supplement accommodation supply under more hotels are built. This will be the next notch up in the cycle which has all of the ingredients to be one of Asia's most dynamic leisure property stories in the next decade ahead.

About the Author

Bill Barnett is the Founder and Managing Director of C9 Hotelworks. The firm is a leading hospitality and real estate consulting firm base in Thailand. With over 29 years of experience in the Asia Pacific region Bill is considered to be a leading tourism and property analyst. C9 has been actively involved in a number of high profile development in Greater Bali, Lombok and beyond and are noted for their market intelligence covering hotels and real estate. One of the groups lead disciplines is hospitality-led residences and hotel branded condominiums and villas.

For more information www.c9hotelworks.com