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## Hospitality industry experiencing an increasing phenomenon to convert hotels into condominiums

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The last several quarters have seen the U.S. Lodging Industry log its first revenue and profit expansion since the massive industry wide recession that followed the 9/11 terrorist attacks. As a whole, the industry achieved occupancy of 67.5 percent in 2004. This is expected to grow to 69.4 percent in 2005, just below the 69.9 percent pinnacle reached in 2000. This trend in profitability is expected to continue for the next several years due to the strengthening economy, increased corporate travel, and a lack of new supply coming online.

While the recovery is being experienced across the whole hospitality industry, there is a more dramatic turn of event in this oft volatile sector, and that is the hotel to condo conversion phenomenon.

An ever-increasing trend has been to convert existing hotels into condominiums. This business plan seems to be taking two distinct paths:

The first being a full condo conversion: where hotels are literally removed from the hospitality sector and fully converted into residential condos. This typically involves a change of use and very significant capital expenditures as two or more hotel

rooms are typically combined to create a reasonable sized apartment condo.

The second and more common path of this trend is being called the Condo-Hotel properties. This is where hotels sell off their rooms individually to buyers. This is a very hot trend that seems to have begun in the hotel markets in Latin America, Europe and Australia where they have been building condo-hotel projects since at least the 1980s. In the United States the concept was mostly isolated to ski towns. Over the last two years, developers across the country began to experiment with the concept. The Trump International Hotel and Tower in Chicago — where Bill Rancic went to work after *The Apprentice* — is a condo-hotel property. Aventura-based Turnberry Associates launched the first Las Vegas condo-hotel last January, and other developers are following suit. The concept is white hot in south Florida where there are more than 30 such projects either open, under construction, or planned from Fort Lauderdale to Key Biscayne. Already, this has changed how South Florida builds luxury hotels, with developers turning to the real estate market, instead of banks, to fund construction costs. By selling ownership of the rooms in advance, developers secure more than enough money to build the hotels without the risk of making loan payments in the rocky early years of a hotel's debut.

Analysts note that only a handful of condo-hotel properties have been open long enough to offer comparisons for

potential buyers; and there's no consensus on whether the units make good investments. The Miami Herald reports that tourism officials are worrying that the move toward individual ownership of hotel rooms could leave too few beds for tourists, as well as, put pressure on the number of hotel rooms available for large conventions. Such conventions typically need thousands of rooms reserved years in advance. Well known examples include the Sonesta Beach Resort in Key Biscayne, which recently announced it will raze the 294-room property to make way for a condo-hotel complex, and Ian Schragger's ultra-hip Shore Club, which has quietly begun compiling a waiting list for buying its 325 rooms. Fort Lauderdale's tourism boosters also are salivating over a wave of luxury hotels slated to open in that former low-budget paradise for spring breakers — projects financed as condo-hotels.

Developers dismiss critics' concerns about a potential shortage of hotel rooms, saying most owners turn their units back to the hotel's rental pool. And they note the condo-hotel model is creating rooms when most banks won't fund hotels. By passing on debt, property taxes and other costs to unit owners, condo-hotel developers open a property with an instant profit on the real estate. Historically, newly constructed hotels needed to "season" for one to three years in order to establish a track record and obtain a cash out refinance or obtain a profitable sale. With this business plan, builders can sell their property day one!

The rational for hotel condo unit owners — who can pay in the low \$100,000s for small hotel rooms or more than \$1 million for an ocean-front suite — is that they get free stays in upscale hotels, instead of the house-cleaning and shopping that often comes with a vacation home. Then when the owner leaves, the unit is offered for rent on a daily basis without any hassles for the owner. Unit owners split operation costs with the hotel in exchange for a share of the room's rental income, typically about 45 percent. But with many hotels losing money their first few years in an always competitive and seasonal market, condo-hotel units are unlikely to be cash cow investments. This fact should not be a great deterrent to buyers who simply wish to lock in a place to stay in their favorite vacation spot.

It is unclear if the condo — hotel buyers are users or investors. Federal securities law bars developers from marketing condo-hotel units as investments, but there is little question investors are fueling many of the projects' pre-sales. Some experienced brokers estimate that ninety-five percent of the first time buyers are really more interested in an investment than in a vacation home. If this is true, rising interest rates, and the harsh economic realities of the hospitality industry, may eventually dishearten the private condo investors, putting a chill on condo — hotel sales.

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