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PROPERTY REPORT | *By Ryan Chittum*

Living Life Like Eloise: More Hotels Add Condos

JUST NORTH of downtown Dallas, Crescent Real Estate Equities Co. is building a 218-room Ritz-Carlton hotel designed by star architect Robert A.M. 'Stern. When it opens next month, guests will be able to get a facial or a massage at the spa, or get room service from celebrity chef Dean Fearing's new spot downstairs.

But the new property isn't just for tourists or businesspeople. It will come with 166 Ritz-Carlton-brand condos and four lavishly appointed homes the developers call "freestanding manors." Condo residents will be able to enjoy the hotel's spa, room service and other amenities. Crescent is including the condos because the amount the Ritz-Carlton will charge for visitors—about \$400 a room—isn't enough for the company to make money.

"To build a luxury hotel today, you really have to look at some component that helps underwrite the cost," says Bill Mabus, vice president of development for Crescent, based in

Fort Worth, Texas.

Had it not been for the condos, it is unlikely that this hotel—or, for that matter, most luxury hotels under construction across North America—would ever have gotten the green light to be built. That is because the cost of land and construction, along with the expense of plush amenities and services needed to be a luxury hotel (such as twice-a-day maid service), have risen faster than the price much of the public is willing to pay for a room. As a result, the only way most developers can afford to build luxury hotels is if they are part of broader development projects that typically include a residential component.

"It makes projects viable that weren't viable," says Laurence Geller, chief executive of Chicago-based Strategic Hotels and Resorts Inc., which is planning a Four Seasons near Mexico City with a condominium component and which has hotel-condominium developments in San Diego

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Palladian Development LLC

Chicago's Mandarin Oriental Tower will have 252 hotel rooms, 260 condos.

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THE PROPERTY REPORT

Hotels Turn to Condos to Make Money

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and Chicago.

Hotel developers are guided by a basic rule of thumb: To be profitable, a hotel should be able to charge at least one dollar in room rate for every \$1,000 it costs to build a room. In the mid-1990s, it cost as little as \$250,000 a room to build a luxury hotel such as a Four Seasons, Mandarin Oriental or Ritz-Carlton—meaning those hotels needed to be able to charge at least \$250 a night to be profitable. But today, it costs \$700,000 a room on average. But most consumers—even wealthy ones—won't pay upwards of \$700 a night for a hotel room. The average room rate for a Four Seasons in the U.S., for example, was \$424 in the fourth quarter of 2006, the last publicly available numbers.

Lodging Econometrics, a consulting firm in Portsmouth, N.H., estimates that 95% of the luxury hotels and resorts in development in the U.S. are being built as part of larger real-estate projects, up from 10% or so in the 1990s. Typically, the revenue from the nonhotel portion of the project subsidizes the hotel rooms and, in most cases, the additional revenue stream comes from sales of condominiums. Sometimes the additional revenue comes from high-end retail space or office space. "This is radically different," says Patrick Ford, president of Lodging Econometrics. "It wasn't always this way."

Fortunately for hoteliers, the growing class of wealthy people embracing hotel living means that sales of these hotel condos have remained solid, even as the broader housing market in many cities is slumping. The business executives, law partners and other highly paid professionals who are typical buyers, boast income that is soaring as globalization helps wealth flow to the top. At the same time, these people are working more hours, traveling frequently and want their limited free time at home to be free of the nuisances of daily life and homeownership.

"Our customers own [multiple] homes, says Mike Minchin, director of planning and residential marketing with **Four Seasons Hotels & Resorts Inc.**, based in Toronto. "Our clients don't want to deal with the headaches of mowing the lawn or maintenance issues, and they don't want to manage a staff of butlers. They want to make sure that's all handled by the Four Seasons. There's very strong demand for that."

It was once fairly standard in the early part of the 20th Century for hotels to have full-time residents, though they were typically renters, not owners. Think of the children's book character Eloise, living at the "tippy-top

floor" of the Plaza Hotel in Manhattan. Today that property is converting much of its space to luxury condos as part of a thorough renovation by its new owner.

Four Seasons' first residential development was in Houston in 1982. It has 17 operating now, with nine in sales and an unspecified number in the pipeline, Mr. Minchin says.

William Rich, vice president of Delta Associates, an Alexandria, Va.-based real-estate-research firm, says hotel-branded con-

more than a 90% premium over comparable apartments that aren't part of a luxury hotel, says Matthew Gardner, a principal with Gardner-Johnson, a real-estate-advisory firm. "The synergies are fantastic," says John Oppenheimer, managing partner of **Seattle Hotel Group LLC**, the \$120 million project's developer.

A 45-story Four Seasons hotel under construction in Denver, the city's first five-star hotel, will have 230 hotel rooms along with 102 condos that the developer says are being sold at a 60% premium because of the brand name and services. The homes start at \$800,000 and top out at \$8 million.

In two weeks, **Palladian Development** will break ground on a 75-story Mandarin Oriental Tower with 252 hotel rooms and 260 condos overlooking Millennium Park in Chicago. Prices start at \$700,000 and top out at the penthouse at \$18 million, and more than half have sold. "People really like the fact that they can take the elevator down to the spa in the morning and pop by to eat or order room service at night," says Chris Kenny, Palladian's chief financial officer.

The trend isn't limited to luxury hotels, although luxury hotels make up the lion's share of the market. According to Lodging Econometrics, 17% of all hotel rooms in development in the U.S. are part of a residential mixed-use project, many of which include so-called condo hotels, not pure residences.

Most residential units for sale in luxury hotels are intended for the exclusive use of the owner. With condo hotels, though, developers sell hotel rooms to individuals who typically can stay in the units as many as 90 days a year. The rest of the time, the unit is rented out nightly like a regular hotel room, with the hotel

management and the room owner splitting the revenue. Hoteliers sell timeshares or vacation clubs as well.

How far luxury hoteliers will push into residences is hard to determine. Even the two biggest names in luxury, Four Seasons and the Ritz, don't see eye to eye on the subject. Mr. Minchin says Four Seasons won't build a purely residential tower because the company believes it can't provide its customary level of service without the critical mass the hotel provides.

But Ritz-Carlton is pushing into branded residential with nine projects that bear its famous name—sans the hotel. The most ambitious test is near Scottsdale, Ariz., where developers are building the first master-planned Ritz-Carlton Community at a cost of \$1.5 billion. Residents will have access to room service, housekeeping and other hotel amenities.



The **Four Seasons Hotel and Private Residences Seattle**, now under construction, will have 149 rooms and 36 condominiums. Two-thirds of the condos have sold at nearly \$2,000 a square foot.

dos are performing better than the overall housing market because "if you can afford a \$2 million condo, you can afford that in good times and bad."

And developers have found they can charge a hefty premium for condos associated with luxury-hotel brands. In Seattle, for example, the 149-room Four Seasons Hotel and Private Residences under construction will offer its 36 homeowners access to all hotel services, including the spa, pool, room service, personal shopping, valet and 24-hour concierge service. For those services, buyers are paying between \$2.5 million and \$10 million for apartments that range from 1,300 square feet for a one-bedroom to 10,000 square feet for a customizable floor plan, despite being next door to the Lusty Lady strip club (Pike Place Market and the Seattle Art Museum are also nearby).

The Four Seasons condos are getting