



Some Reflections on Condominium Hotel Development

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As evidenced in our work on a number of condominium hotel or condo-hotel projects in the past few years, the success of a condominium project is not necessarily dictated by or related to the success of the underlying hotel's performance. Most condominium projects are located in established destination resort markets. In the current economic environment, even with low-cost and readily available financing, development of a traditional wholly-owned full-service resort hotel is unlikely to pencil based on the increasing costs of construction. At this point in the development cycle, it would be a rare project where the hotel would be successful without a supplementary source of cash flow from residential, fractional, or condominium hotel sales.

From a developer's perspective, the same number of units designed in a condominium hotel project can more than make the project pencil, they can produce a substantial profit. To illustrate the potential profitability of a condominium hotel project, consider the stabilized operating income statement for a 150-room luxury resort shown in **Table 1**, in the box at the right.

To convert the forecast into value, an 8.0% capitalization rate was used. The net present value of the loss income during ramp up was then deducted. This procedure indicates the following value.

Table 2: Value Indication – Hypothetical 150-Room Resort

Net Operating Income	\$5,800,000
Overall Capitalization Rate	8.0%
Indicated Value	\$72,500,000
Less Income Loss during Ramp-up	4,800,000
Adjusted Value	\$67,700,000
Per Room Value	\$451,333

Consider the same 150-room resort sold as condominium units. Assuming that each guestroom is roundly 600 square feet and sells for \$1,250 per square foot, the average sales price is \$750,000 per unit. For branded

Table 1: Stabilized Forecast – Hypothetical 150-Room Resort ('000s)

Number of Rooms:	150			
Occupancy:	74%			
Average Rate:	\$375.00			
RevPAR:	\$277.50			
Days Open:	365			
Occupied Rooms:	40,515	%Gross	PAR	POR
REVENUE				
Rooms	\$15,193	52.9 %	\$101,287	\$375.00
Food	7,495	26.1	49,969	185.00
Beverage	1,499	5.2	9,994	37.00
Telephone	236	0.8	1,572	5.82
Spa	3,059	10.7	20,396	75.51
Other Income	1,224	4.3	8,159	30.21
Total Revenues	28,706	100.0	191,375	708.54
DEPARTMENTAL EXPENSES *				
Rooms	3,950	26.0	26,335	97.50
Food & Beverage	7,016	78.0	46,771	173.16
Telephone	150	63.6	1,000	3.70
Spa	2,142	70.0	14,277	52.86
Other Expenses	454	37.1	3,027	11.21
Total	13,711	47.8	91,410	338.43
DEPARTMENTAL INCOME	14,995	52.2	99,966	370.11
UNDISTRIBUTED OPERATING EXPENSES				
Administrative & General	2,297	8.0	15,310	56.68
Marketing	1,722	6.0	11,483	42.51
Prop. Operations & Maint.	1,148	4.0	7,655	28.34
Utilities	718	2.5	4,784	17.71
Total	5,885	20.5	39,232	145.25
HOUSE PROFIT	9,110	31.7	60,734	224.86
Management Fee	1,076	3.8	7,177	26.57
INCOME BEFORE FIXED CHARGES	8,034	28.0	53,557	198.29
FIXED EXPENSES				
Property Taxes	718	2.5	4,784	17.71
Insurance	344	1.2	2,297	8.50
Reserve for Replacement	1,148	4.0	7,655	28.34
Total	2,210	7.7	14,736	54.56
NET INCOME	\$5,823	20.3 %	\$38,821	\$143.73

*Departmental expenses are expressed as a percentage of departmental revenues.



condo hotel projects, a number of units are often held by the developer. The following scenario illustrates the potential value of the same property as a condominium hotel project assuming 85% of the guestroom inventory is sold:

Table 3: Value Indication–Hypothetical 150-Room Condominium Hotel

Average Guestroom Square Footage		600
Number of Guestrooms		150
Total Sellable Square Footage		90,000
Percentage to Sell	85%	76,500
Price per Square Foot		\$1,250
Gross Sales Proceeds		\$95,625,000
less Sales and Administrative Costs	12%	11,500,000
Net Sales Proceeds		84,125,000
less Profit	10%	8,400,000
Proceeds from Unit Sales		\$75,700,000

In addition to the revenue from the unit sales, the 15% of held units and the remaining commercial hotel operation yield an additional value. The income statement show earlier was adjusted for the condominium hotel ownerships for the blended rooms revenue and shared expenses. The rooms revenue calculation is set forth in the Table 4:

Table 4: Adjusted Rooms Revenue

Occupied Owned Rooms		6,077
RevPAR		\$277.50
Owned Room Revenue		\$1,686,437
Occupied Rental Program Rooms		34,438
RevPAR		\$277.50
Gross Room Revenue		\$9,556,476
Developer Retention	50%	\$4,778,238
Total Room Revenue		\$6,464,675

The developer retains all of the other revenue and is obligated to pay a share of the operating expenses. In the following example, the repairs and maintenance and energy expenses are share 85% individual owners and 15% developer while 25% of the administrative and general expenses are allocated to the individual owners. Property taxes, insurance, and reserve for replacement are allocated 85% to the individual owners and 15% to the developer. (Table 5, at right)

Table 5: Income Statement - Hypothetical 150-Room Condominium Hotel

Number of Rooms:	150			
Occupancy:	74%			
Average Rate:	\$375.00			
RevPAR:	\$277.50			
Days Open:	365			
Occupied Rooms:	40,515	%Gross	PAR	POR
REVENUE				
Rooms	\$6,465	32.4 %	\$43,098	\$159.56
Food	7,495	37.5	49,969	185.00
Beverage	1,499	7.5	9,994	37.00
Telephone	236	1.2	1,572	5.82
Spa	3,059	15.3	20,396	75.51
Other Income	1,224	6.1	8,159	30.21
Total Revenues	19,978	100.0	133,186	493.10
DEPARTMENTAL EXPENSES *				
Rooms	3,950	61.1	26,335	97.50
Food & Beverage	7,016	78.0	46,771	173.16
Telephone	150	63.6	1,000	3.70
Spa	2,142	70.0	14,277	52.86
Other Expenses	454	37.1	3,027	11.21
Total	13,711	68.6	91,410	338.43
DEPARTMENTAL INCOME	6,267	31.4	41,777	154.67
UNDISTRIBUTED OPERATING EXPENSES				
Administrative & General	1,722	8.6	11,483	42.51
Marketing	1,722	8.6	11,483	42.51
Prop. Operations & Maint.	172	0.9	1,148	4.25
Utilities	108	0.5	718	2.66
Total	3,725	18.6	24,831	91.93
HOUSE PROFIT	2,542	12.8	16,946	62.74
Management Fee	1,076	3.8	7,177	26.57
INCOME BEFORE FIXED CHARGES	1,465	9.0	9,769	36.17
FIXED EXPENSES				
Property Taxes	108	0.5	718	2.66
Insurance	52	0.3	344	1.28
Reserve for Replacement	172	0.9	1,148	4.25
Total	332	1.7	2,210	8.18
NET INCOME	\$1,134	7.3 %	\$7,559	\$27.99

*Departmental expenses are expressed as a percentage of departmental revenues.

As reflected in the in the following table, capitalizing this net operating income provides roundly 19% more value to the hypothetical condominium hotel.

Table 6: Commercial Remainder Capitalization

Net Operating Income	\$1,133,824
Overall Capitalization Rate	8.0%
Indicated Value	\$14,200,000



The aggregate value of the project as a condominium hotel far exceeds its value as an operating hotel.

Table 7: Indicated Value – Condominium Hotel

Proceeds from Unit Sales	\$75,700,000
Value of the Commercial Remainder	14,200,000
Indicated Value	\$89,900,000
Per Key Value	\$599,333

As seen in the following chart, this simplistic example shows a roundly 33% difference in the per-key value, demonstrating why successful hotel condominium projects appeal to developers.

Table 8: Value Differential

Condo Hotel Per Key Value	\$599,333	
Wholly-owned Per Key Value	\$451,333	
Difference	\$148,000	32.8%

The value difference can be considerable, particularly in the distribution of cash flows to developer. Condo-hotels generate significant cash flow either during the sales process or immediately upon completion, depending on state law. The developer can pay down debt from the condo-hotel sales proceeds whereas the net operating income ramp-up of a new wholly-owned property would typically have debt-service shortfalls in the first year or two operations, requiring the developer to come out of pocket with additional equity.

Successful condo-hotel projects share distinctive attributes. The projects are typically located in established destinations that are easily accessible to the individual-unit owners. Successful condominium hotel projects need not be feasible as a traditionally financed hotel, but must be located in desirable destinations and designed to the potential buyers.

Joel Green, an established broker of individual condo hotel units, maintains in his summary of 2006 trends that the most appropriate buyers of condo hotel units are wealthy individuals interested in buying a “hassle-free” vacation home. These buyers would like the rental proceeds to cover some or all of the costs of ownership and the property to appreciate, but are not typically speculators.

Condominium properties located in such destinations as Cabo San Lucas, Mexico, parts of Florida, ski resorts, and Hawaii, among others, continue to attract unit buyers and developers. Well-located and well-designed properties are expected to be successfully marketed even as the residential

condominium markets soften. The purchase of hotel condominium units by second-home buyers with disposable income is not driven by the same dynamics as those of the residential condominium or second-home buyer. Many buyers are purchasing units with the intent of using the resort for vacation as well as considering the property as an endowment for their children. These buyers have well-funded retirement plans and are not swayed by short-term residential pricing swings. With the inherited and earned wealth currently held by older and retiring baby boomers, condominium hotel properties in attractive destination areas can be a more successful development than a traditional operating resort.

About the Author:



Elaine Sahlins is Senior Vice President with HVS International's San Francisco, California office. She holds an undergraduate degree from Barnard College, Columbia University in New York City and an MPS degree in Hotel Administration from Cornell University. After graduating from Cornell she worked for VMS Realty in Chicago analyzing hotel investments, and then went on to join Security

Pacific in San Francisco, which was subsequently acquired by Bank of America. She joined HVS International in 1987 as a Director in the San Francisco office. Ms. Sahlins also, with Suzanne Mellen, directs HVS Gaming Services, and Shared Ownership Services in the San Francisco office.

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