

DECEMBER 9, 2005

**CONDO-HOTEL LIVING**

By Christopher Palmeri

## Checking Out -- and Into -- Condo Hotels

**You buy a room and building management rents it out whenever you're not around. A sound investment? Well, that remains to be seen**

When Keith and Kimberly Hartke heard that the Fontainebleau Resort in Miami Beach was building a new condominium tower, they were ready to buy, quickly plunking down \$600,000 for a 1,000-square-foot one-bedroom unit. Keith had vacationed at the hotel as a child and returned as a newlywed with Kimberly years later. But what sold the Hartkes on investing in a property wasn't their history with the resort. It was the fact that they could rent the unit out like a hotel room when they weren't using it. "It's not just a condo at the beach," Kimberly says. "We're getting in the hotel business."

The Hartkes are charter members of the latest trend to hit the hospitality industry: the condo hotel. By uniting the public's desire to invest in real estate with the travel industry's quest for new properties, the condo hotel has reinvigorated the hotel construction business and begun altering the skyline of cities such as Miami and Las Vegas.

**BOOMING BUSINESS.** Grand old hotels such as the Plaza in New York and the Hotel Del Coronado in San Diego are carving out pieces for small investors. Donald Trump now has six condo-hotel projects in the works in Chicago, Fort Lauderdale, Miami, Phoenix, Las Vegas, and Dubai. "Other than that we're not so busy," Trump says.

All the building and converting has longtime hotel-industry watchers baffled. Is it a sign that baby boomers are once again influencing market trends, in this case seeking second "homes" that provide a **vacation spot with few of the hassles of real estate ownership**? Or is it another manifestation of a real estate bubble that people are willing to pay top dollar to own something as impersonal as a hotel room?

"It's all the rage," says Robert Mandelbaum, director of research at hotel consultants PKF Consulting. "Everyone's asking, 'Is it a flash in the pan or something that's here to stay.'"

Unlike time shares, where owners have the right to visit a property for a few weeks a year, or traditional condominiums, where individuals own the units and can do what they want with them, **condo hotels are a hybrid. Investors own a specific condo and pay property taxes, insurance, and maintenance fees.** Hotel management companies rent out the rooms, rotating reservations among the various units and splitting the revenue

fifty-fifty with the owners.

Units often come furnished and owners can't make changes to the decor or add personal items such as photos. "You wouldn't know the room is owned by somebody else," says Rick Davis, a Los Angeles attorney specializing in condo-hotel projects.

**CHECKING IN.** At the Fontainebleau, hotel management asks owners for notification at least 60 days in advance if the owners want to use their unit. When they do stay, owners are charged housekeeping fees that begin at \$30 a day. They are also subject to 3 p.m. check-ins and 11 a.m. check-outs, just like any hotel.

"You need somebody with the right mindset," says Bruce Weiner, president of Turnberry Associates, which is developing the Fontainebleau condos and others in Las Vegas and the Bahamas. "If it's somebody looking for a retirement home and socialization this is not the right product. Your next door neighbor could change every day."

Developers love the concept because they can recoup much of their construction cost up front and still retain ownership of meeting facilities, restaurants, spas, and some traditional hotel rooms. Of the roughly 377,000 hotel rooms under development in the U.S., 30,500 are condo-hotel units. An additional 70,000 are private residences within hotels that are not designed to be rented out on a nightly basis, according to Lodging Econometrics, a research firm that collects hotel construction data.

At the high end -- where construction costs are greater -- condo hotels are an even larger slice of the market. "There's not a luxury hotel under consideration that doesn't have a condo piece with it," says Jan Freitag, who follows the industry at Smith Travel Research.

**"BUYING A LIFESTYLE."** The condo-hotel concept isn't all that new, really. There was a wave of buying in the 1970s when developers sold units more like investments, often structuring them as partnerships and registering them with the U.S. Securities & Exchange Commission. Lawsuits followed when returns didn't live up to the promises. Today condo-hotel salespeople are instructed not to make specific references to room rates or occupancy levels.

"Most of these deals are not priced in a way that they'll provide an immediate return on investment," says James Butler, a real estate attorney in Los Angeles. "You're buying a lifestyle and a long-term capital gain."

Indeed, a condo-hotel room at the J.W. Marriott Camelback Inn in Scottsdale, Ariz., that sold for \$55,000 in 1972 traded hands recently for \$195,000. It's projected to generate income of \$9,500 this year, after maintenance, taxes, and insurance expenses. That's not enough to cover the mortgage payments on a conventional loan, though -- and that's in a year when room rates have been robust. Last year's income was just \$6,300.

**IN TOO DEEP?** Some major hotel operators still harbor doubts about the concept, fearing that the money pouring in from individual investors is causing projects to be

launched that would not be built otherwise. Hilton Hotels (HLT ) has a handful of condo-hotel projects, mostly under its Conrad luxury brand, but the company is treading with care.

"We're very selective," says Matthew Hart, Hilton's president. "You have to be very careful that the project is viable as a hotel."

Already, some condo-hotel projects in the red-hot Las Vegas market have been scuttled. "Make sure the developer has a track record in the business and is not just looking to make a quick buck," advises John Burnett, president of Kor Hotel Group, which is building a \$175 million condo hotel in Anguilla.

**ROOM WITH A VIEW.** Kimberly Hartke admits that the income from their Fontainebleau unit hasn't covered expenses, a fact she attributes to a change in management at the hotel and continued construction on the property. Still, the Washington (D.C.)-area couple has used the condo three times since taking ownership in February. They have lent the unit out to family and are using it as an employee perk for Keith's commercial real estate business.

Recently they enjoyed the twinkling lights of a nighttime regatta from their 17th-floor perch. "It's just the perfect second home," Kimberly says. But smart buyers will remember that it's also getting them into the hotel business.

# Reader Comments

## Checking Out -- and Into -- Condo Hotels

**Nickname:** egy

**Review:** The bottom line is location and name brand. View can also be critical. I bought one at Trump Las Vegas and very optimistic that it will do well. For a tourist destination, how can one go wrong?

**Date reviewed:** Jun 2, 2006 9:56 PM

**Nickname:** san

**Review:** The article is eye opener and the comments that followed are very enlightening. Having said that, I know the Hard Rock Hotel ( HRH) project too well. Don't ask me what does that mean? I know the location, surroundings, charm of SD, the teeming crowd walking by the location day in and day out with a lap top hanging off the shoulder and Starbuck in their hands, south end of Gas Lamp Quarter, not much of real estate between it and the Convention Centre ( Trolley tracks- on grade crossing). The weather is always what the rest of the country would desire to have 12 months out. The location is surrounded by Hilton, Omni and Marriott ( an indicative of the prime location- right?) and at the front of the action being closest to Convention Center. The management and the developer have a great track record with about 25 brand hotels of various type in CA and in the hospitality business for 30 years. The team involved with the project is class A. Could an investor goes wrong in this case? Comment?

**Date reviewed:** May 3, 2006 11:35 PM

**Nickname:** griffy

**Review:** Everyone has different goals for their investments but mine has always been to break even month to month or come close and let appreciation work its magic. The demand will be getting higher and higher for these type of units in the years to come. Close to 4 million baby boomers(around 5% or more of the 70+ million) will be looking to buy second homes in the next 15 years and many of them will want brand names, "hassle-free living,, luxury amenities, low maintenance, and popular locations. This is what the condo hotel provides. Get into the first phase of selections, purchase a modest- to low-end unit with good views, and reap the benefits. Think of it as a business and treat it as such. Please respond with opposing views if you have them.

**Date reviewed:** Apr 25, 2006 7:24 AM

**Nickname:** griffy

**Review:** Condo hotels are great investments if you find the right ones. Location, branding (management), and the developer are the three key things to look at right away. Take the Hardrock in San Diego. You put a brand like Hardrock into an already booming downtown area, position it right in between Petco Field and the convention center, offer units starting in the mid-300k range with 4-diamond services and you've got yourself a winner for the lucky few who get

in first. People need to realize you are buying into the hotel business. If the hotel does poorly it's you who takes the hit. Your unit will only do as well as the brand that is running it. The brands that have historically proven to do well will continue to have good occupancy rates. These are the condo hotel units to focus on not only to help offset your costs but also for appreciation.

**Date reviewed:** Apr 25, 2006 7:22 AM

**Nickname:** spaceman

**Review:** I've done a lot of research into this type of investment and have come to the conclusion that it's a poor investment. First of all, if you are looking for a vacation get-a-way, it is much, much cheaper to simply rent a room when you need one. Most condo-hotels generate negative cash flow when all is said and done. Think about how easy it will be to sell a condo-hotel unit that generates negative cash flow. Now imagine selling in a soft market, or worse, a declining market. Now think about how much risk the developer has. They basically get all the construction costs up front, charge you a monthly "maintenance fee" and take 50% of the rental rate! Must be nice being a developer of one of these. :-)

**Date reviewed:** Mar 13, 2006 6:03 PM

**Nickname:** Soooz

**Review:** I love the condo hotel concept. When I use my condo, I get access to the hotel's five-star amenities and services. When I'm not there, my unit is generating revenue from visitors, and that revenue helps offset my costs of ownership. Plus, I love owning a vacation home that is 100% hassle-free. The management company handles everything, from finding guests to maintenance and upkeep. When we decide to sell, we believe our condo will have appreciated significantly.

**Date reviewed:** Dec 27, 2005 3:46 PM

**Nickname:** rone

**Review:** The condo-hotels of yesteryear are not the same as they are today. Today we are talking Four Seasons, W, St Regis, Hard Rock--highly skilled operators that know their business and the markets they are in. If I could purchase a hotel in a highly desirable destination--like San Diego--I would. It's the best performing hotel market in California. But low and behold, I cannot afford the entire hotel. So I have been looking at The Diegan and the new Hard Rock Hotel. Both seem to be priced well above the average price per square foot for new and resale condos. But when you consider all the amenities, the services and the potential rental income, they are attractive ways of being able to own in a place in love, without all the hassles and headaches of traditional second home real estate. So when you get away from looking at condo-hotels as investments in the traditional sense and back to the real estate, the condo-hotel concept makes a great deal of sense for many.

**Date reviewed:** Dec 25, 2005 2:06 PM

**Nickname:** Tas

**Review:** Third, you are never required to place your unit into the rental program. You are buying real estate. Fourth, many buyers will pay cash for their vacation home making the numbers work remarkably well. After all, would you really want all your savings invested in the stock market? I ran a small public company for years and I can tell you it's the biggest game in town. It's all

about the story and seldom about the business. Fifth, if you buy in the right location and run your condo as a business you can achieve higher occupancy levels than just entrusting the entire process to the hotel. Sixth, the amenities are important to people wishing to be pampered. The condo I own had a little poolside cafe available to the owners which I absolutely loved. It closed because most of the condos are like mine, they sit empty. The only way to support the amenities is to have a constant customer base of owners and renters. I have many more thoughts but would like to read your comments.

**Date reviewed:** Dec 17, 2005 8:19 PM

**Nickname:** Tas

**Review:** Excellent comments, however, I'd like to share my thoughts. Please feel free to shoot holes in my theory as I always welcome opposing views. I truly believe in the condo hotel concept. My reasons are many. First, I bought a "regular" condo on the beach five years ago. At the time it was quite a stretch financially. Today, that condo has tripled in value to over \$1 million dollars. It has changed my life. The condo is never rented due to rental restrictions. The unit is paid off limiting my cash out of pocket. It still costs some \$25,000 a year to own the place but the appreciation is running well over \$100,000 per year. Most of the year it sits empty and generates not one dollar of income. Second, the dream of any retired person is to have a fabulous vacation home where they and their kids can enjoy the fruits of their labor. The richest generation to ever retire is reaching retirement age now. This should generate demand for rentals and ownership in the years to come.

**Date reviewed:** Dec 17, 2005 8:07 PM

**Nickname:** PuzzledAndWorried

**Review:** Every day I ask this question of myself and get no answer: Where exactly are people getting all of this speculation money? Have folks been hiding dollars under their mattresses since they were nine years old? The average "investor" is a middle-class couple that watches too much CNBC and HGTV to know the first thing about capital markets, real estate investing, and cash flow. These investments will be the focus of many a lawsuit in 24 months. Remember it!

**Date reviewed:** Dec 16, 2005 4:25 PM

**Nickname:** DonaldD

**Review:** I owned a condo at Kahler Glen near Lake Wenachi in Washington State. We sold it at break even after five years. Totaling all associated costs, it was cheaper to rent a unit when you wanted one unless you used it three weekends per month.

**Date reviewed:** Dec 12, 2005 11:12 PM

**Nickname:** Beach Heat

**Review:** This is a recycled con job. I saw the identical story being pitched in Honolulu in the '70s and '80s. Throw in a little appeal to greed-"you're making an investment in prime real estate" from the early days of vacation timesharing, which is now being taken out of condo-hotel pitches just like it was taken out of timesharing, and this the newest verse of the same old song. It's remarkable how today's craze is such a perfect repeat of 25 years ago. The craze starts when real estate prices are approaching a peak. The investment angle is hinted at. The cash flow is

negative. The expenses charged by the hotel after it's sold out get out of hand. The restrictions on use soon make it not so desirable for personal use. Five years from now when the hotel decides to refurbish what you think is still a perfectly serviceable and appropriate accommodation, you wonder, "What did I get into?" At best the resale value will increase less than surrounding real estate; at worst it goes down.

**Date reviewed:** Dec 12, 2005 1:21 PM

**Nickname:** Dwildone

**Review:** If you're interested in a condo/hotel investment look at the reasons to rent in this location. All resort properties have a limited season with little demand for off-season. Commercial hotels have a demand 365 days of the year. Yes there is less motivation for the "vacation" owner, but the investment income will allow the owner to afford going on vacation.

**Date reviewed:** Dec 12, 2005 12:32 PM

**Nickname:** David Fitzpatrick

**Review:** I certainly agree that these types of units are a poor investment if it is income you are hoping to generate. Income seems to barely cover costs (if at all). Of course this depends on how frequently the suite is rented and how often you use it yourselves. However, the comment about how owners will be selling at a fractional cost doesn't seem to be supported yet. At least to my knowledge, the resell value of these units often increases substantially. Perhaps things will change if the market crashes. Overall, my family sees the property as a way to basically have a cost-free get-away available whenever they like. It doesn't generate income, but we also don't have to pay \$300 dollar a night for typical hotel-room prices.

**Date reviewed:** Dec 11, 2005 11:13 PM

**Nickname:** srini

**Review:** How is this different from the time-share business?

**Date reviewed:** Dec 11, 2005 1:16 PM

**Nickname:** Scamdelight

**Review:** I made a good faith effort to understand how condo/hotel could possibly work for anyone. Firstly, you must be prepared to be out of pocket \$3,000 to \$4,000 monthly on an investment of \$1 million for a unit. This is the most sophisticated legalized scam of the century, aimed mainly toward baby boomers that are flush with home equity and too eager to invest in a second home and not capable of fully understanding the real upfront costs of this really poor one-sided investment. Of course, the developers will not sell them as "investments" because it is not. It is a sinkhole and owners will keep losing money on a monthly basis until they are so desperate they resell it at a fraction of the price they paid. The numbers do not work to the benefit of the buyer but definitely works for the developer.

**Date reviewed:** Dec 10, 2005 7:30 PM

**Nickname:** Mr Realtor

**Review:** Great article. I like that you stress if you're solely doing it for the returns to not do it. Truly it's a great, low-risk way of owning a second home for near no cost. You get appreciation and depreciation. **The key is always like any real estate -location.**

**Date reviewed:** Dec 9, 2005 8:59 PM

**Nickname:** Edward

**Review:** My mother bought a one- bedroom condo at a resort in Maui in the mid 1980s, and it has increased in value at least two and a half times since then. She does get income from the rental fees, which are pooled together for the whole resort, but she also has to pay hotel sales taxes, property taxes, room redecorating fees, etc. **It is a good investment but it is not a stellar source of income.** On the other hand, she does get to stay there during the winter rent-free, but she receives no rental income during her stay. **This article is absolutely correct in stating that the reputation and quality of the resort property is critical.** Before making an investment of this kind, you must do due diligence on the resort as a hotel property, because you are essentially buying a franchise.

**Date reviewed:** Dec 9, 2005 6:56 PM

**Nickname:** purebushit

**Review:** "You need somebody with the right mindset..."; yeah, like brain-dead. To pay \$600,000 upfront, pay taxes, maintenance and housekeeping, while splitting the revenue -- what other "mindset" would possibly buy into such a sweetheart deal for the developer and hotel operator?

**Date reviewed:** Dec 9, 2005 5:46 PM