www.REBusinessOnline.com December 2017 · Volume 16, Issue 4

HEARTLAND REAL ESTATE BUSINESS®

The Midwest's Real Estate Source

MYRIAD FACTORS DRIVE HOTEL BUILDING BOOM

Brand diversification, boutique desires and healthy investor appetites boost today's hospitality sector.

By Kristin Hiller

First Hospitality Group is currently developing the first-ever hotel located directly on Chicago's Navy Pier. The five-story property will feature a rooftop bar and 200 rooms, each with a balcony overlooking the water.

There is no shortage of hotel construction nationally, but room demand is more than keeping pace. Year to date through October, the total supply in the U.S. hotel sector increased 1.8 percent over the same period a year ago while room demand climbed 2.6 percent, according to research firm STR.

The hotel industry appears to be approaching a tipping point, however. Driven in part by increased brand diversification, supply growth nationally is expected to overtake demand growth in 2018 for the first time since 2009, according to *Emerging Trends in Real Estate*, an annual forecast compiled by PricewaterhouseCooopers

see HOTELS page 19

OHIO CAPITALIZES ON INDUSTRIAL DEMAND

From Columbus to Cleveland and Cincinnati, the Amazon factor makes its mark.

By Kristin Hiller and Matt Valley

Approaching the end of 2017, the U.S. industrial sector continues to outperform other commercial real estate property types thanks largely to the booming e-commerce industry. Nationally, e-commerce sales grew 16 percent in the second quarter year over year, and now represent 10 percent of all non-auto retail sales, reports Colliers International.

Heartland Real Estate Business took a look at the industrial markets of Ohio, including Columbus, Cleveland and Cincinnati, to assess their current vital signs, construction activity and advantages for industrial growth.

Columbus keeps building

Industrial development is booming in metro Columbus with more than 4.5 million square feet under construction as of the third quarter, according to Colliers. Activity is fairly evenly split between build-to-suit and speculative construction.

What's more, construction activity in metro Columbus ranks No. 11 on a Colliers list for the top 20 industrial markets for new development since 2010. Improved economic fundamentals and the advent of e-commerce have paved the way for the unprecedented amount of industrial development in this time period.

"The speculative space has been a little bit slower in lease-up, which is due to some tenants opting for build-to-suits," says Douglas J. Swain, vice president and general manager at Opus Development Co. "Columbus has been very active in the 250,000- to 300,000-square-foot building size."

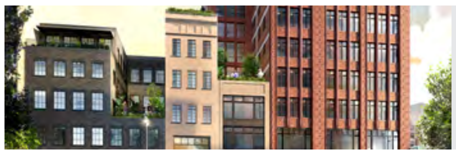
Swain expects these mid-size industrial buildings to continue to be a long-term development trend for Columbus.

"Next year, I think developers will pause big-box construction and wait for some of the existing inventory to get leased," he explains.

Opus is currently developing a 250,050-square-foot building off Allen Creek Road and Spiegel Drive for The Meritex Co. The speculative building, which will feature 32-foot clear heights and truck ports, will accommodate up to four tenants. The project is slated for completion in May 2018.

Also expected to deliver next summer is Rickenbacker West I, an 802,390-square-foot speculative building from developer partners PCCP and The Pizzuti Cos. The property, featuring 36-foot clear heights, will be situated on 50 acres in the Ricken-

see OHIO page 21



BRAND DIVERSIFICATION AMONG FACTORS DRIVING HOTEL BUILDING BOOM

HOTELS from page 1

(PwC) and the Urban Land Institute (ULI).

Adding credence to that outlook is a joint forecast by STR and Tourism Economics that calls for supply growth of 2 percent in 2018, slightly outpacing demand growth of 1.9 percent.

"An unprecedented number of hotel brands have been launched in recent years, driven by the intent of lodging companies to create further demand segmentation, drive differentiation and expand their footprints in a mature U.S. market by capturing previously independent properties through soft branding," says the PwC and ULI report.

Examples include Marriott's Autograph Collection, Hilton's Curio, Best Western's Vib and Hyatt's Unbound.

According to Nate Sahn, senior vice president with CBRE Hotels in Chicago, hotel companies are growing their portfolios by launching new brands within different hotel segments.

"It's happening across all sectors — limited service, extended-stay, full-service and boutique," he says. "We're definitely seeing no shortage of brands popping up on the landscape."

Rapidly expanding across the Midwest is the Home2 Suites by Hilton, an extended-stay hotel chain. Fishers, Indiana-based Dora Hotel Co. LLC is currently developing a Home2 Suites property in Terre Haute, which is located in western Indiana. The 91-suite hotel is slated to open in September 2018.

The property will be the second extended-stay hotel in the city, according to Chrissy Johnston, a corporate sales manager for Dora, a hotel management and development firm. When considering hotel development, Dora closely monitors a market and what type of additional hotel space is needed, says Johnston.

Tru by Hilton is opening its first Midwest location in Cedar Rapids, Iowa, early next year. Smaller rooms are intended to keep Tru hotels at more affordable prices than other Hilton-branded hotels.

The first Avid hotels, the counterpart to Tru, from Intercontinental Hotels Group (IHG) are slated to open in 2019. Price points are expected to be about $10 to $15 less than IHG's Holiday Inn Express brand, according to the company's website.

The experience is key

Soft branding is one big reason boutique hotels are hot right now, according to Robert Habeeb, president and CEO of Rosemont, Illinois-based First Hospitality Group Inc. (FHG). Soft branding is the term used when big hospitality brands independently position properties in order to appeal to guests looking for unique hotel experiences.

"All the big-name companies have come out with brands that are by all accounts boutique. They look and feel boutique but they have the brand behind them," explains Habeeb.

The advantage of having a name like Marriott or Hilton behind the boutique hotel is the established reservation system in place, backed by loyalty programs. Marriott's rewards program now has 100 million members, according to Habeeb.

"You get to develop a cool, hip hotel with the muscle of a major brand behind you. That's a great benefit," he says.

Much like the retail scene, consumers today are all about the experience, he adds. This is fueling the development of boutique hotels.

FHG is currently developing a hotel on Chicago's Navy Pier. Each of the 200 rooms will have its own balcony overlooking the water. The five-story hotel is slated for completion in 2019.

Also in Chicago, the Hard Rock Hotel is closing to make way for a boutique hotel. Property owner Becker Ventures and manager Aparium Hotel Group plan to reposition the property as the St. Jane Chicago, which is slated to open in spring 2018.

The hotel is located at the historic Carbide & Carbon building, which was built in 1929 and designed by the Burnham Brothers, an architect duo that designed a handful of buildings constructed in Chicago in the 1920s.

Renovations as part of the reflagging will consist of updated interiors with the addition of a rooftop bar and lounge, full-service restaurant, market café, cocktail bar and 11,000 square feet of meeting and event space.

"Repositioning and reflagging has

Becker Ventures and Aparium Hotel Group are repositioning Chicago's Hard Rock Hotel as the St. Jane Chicago, a boutique hotel slated to open in spring 2018.

always been a big vehicle for development in the hospitality industry," says Habeeb. "If all goes as planned, you take advantage of the upside."

It takes two

Besides soft branding, dual-branded developments — two hotels with different price ranges but located on the same property and under the same parent brand — are also quickly expanding.

"Dual branding has grown significantly over the last five plus years since it was first introduced. All the brand families are capitalizing on it," says Sahn with CBRE. "It allows brands to put a larger footprint into a market."

Other advantages of dual branding include having the same property management system in place and targeting two types of guests for greater economic benefit.

FHG is developing Hilton's first triple-brand hotel at Chicago's McCormick Place, the largest convention center in North America. The property will consist of a Hilton Garden Inn, Hampton Inn and Home2 Suites. Construction began early this year with completion slated for late 2018. All told, the property will span 379,500 square feet, include 23 floors and feature 466 rooms.

The concept provides savings on operational costs and allows for larger communal areas and amenities. A rooftop dining lounge experience, developed by Concentrics Restaurants, will total 9,500 square feet on the 22nd floor.

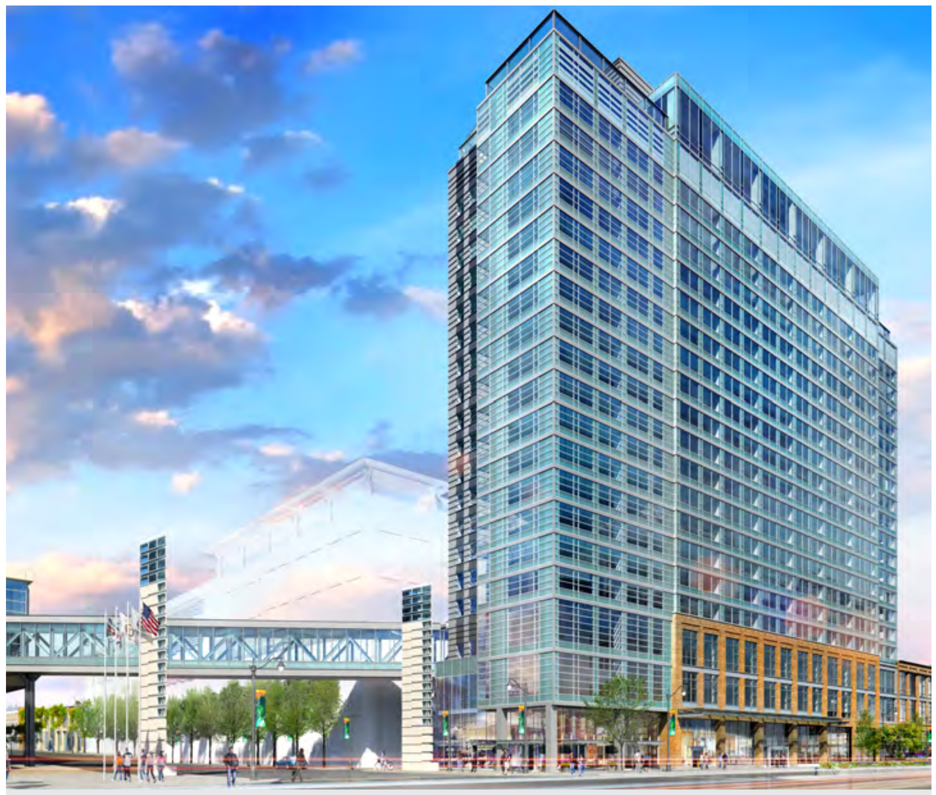
FHG will also manage a dual-branded hotel opening in early 2018 in the Illinois Medical District, two miles west of the Chicago Loop. The combined Hampton Inn and Homewood Suites will feature 240 rooms and shared amenities such as a pool, fitness center, lobby, business center and meeting spaces. Gateway Partners is developing the surrounding 10-acre mixed-use project.

Habeeb admits there has been a lot of concern expressed about overbuilding in Chicago, but he says he's pleased with how demand has kept pace.

"It appears thus far that the demand side of the equation has proven to be more robust than most people expected, and that's helped us absorb the product that we've seen thus far," he says.

At the end of the third quarter, 25 hotel projects totaling 3,616 rooms were under construction in Chicago, according to Lodging Econometrics. An additional 25 projects will start construction in the next 12 months. In Indianapolis, 16 hotel projects are under construction totaling 2,243 rooms.

In Indianapolis, Johnston of Dora also remains optimistic about strong consumer demand in 2018 with the addition of new companies and tech firms such as Infosys and Cummins choosing to make downtown Indy home.



First Hospitality Group is developing Hilton's first triple-brand hotel at Chicago's McCormick Place. The property will consist of a Hilton Garden Inn, Hampton Inn and Home2 Suites spanning a combined 379,500 square feet, 23 floors and 466 rooms.

"Though the second half of 2018 will be soft convention-wise, the increase in corporate business in the downtown market will help fill the gaps during softer months when we usually look to conventions to fill hotel rooms," she says.

Helping drive demand in Chicago is a healthy business climate evidenced by a large number of corporate migrations to downtown and a robust tourism industry. A record 54.1 million people visited Chicago in 2016, according to the *Chicago Tribune*.

"From a consumer standpoint, it's a city that people love to visit and love to relocate to," says Habeeb. "We see this market growing." ■

Seeking safe haven, foreign investors continue to invest in U.S. hotel sector

Foreign investors are particularly attracted to large hotel transactions, say $30 million and up, according to Rushi Shah, principal and CEO of Chicago-based Aries Conlon Capital.

Foreign capital is drawn to the U.S. commercial real estate market like a magnet because it's considered a safe haven, explains Shah. The foreign capital comes from large corporations, pension funds and sovereign wealth funds that want to move their money due to geopolitical risk. Examples include South Korea, Israel, Kuwait, Saudi Arabia and Qatar.

China is also a player. Last year, Anbang Insurance Group purchased Strategic Hotels & Resorts Inc. for $6.5 billion in a megadeal.

For their part, lenders are generally more cautious about hotels than other commercial real estate property types, but they recognize there is strong demand from domestic and foreign investors for cash-flowing assets. That said, most construction lenders do not have a large appetite for hotel development at this late stage of the real estate cycle given the inherent risks.

Lenders are more willing to refinance properties or provide acquisition financing. Aries Conlon Capital arranged a $62.4 million non-recourse loan for the refinancing of a seven-hotel portfolio in seven states. Shah arranged the loan with an international investment bank on behalf of the borrower, Inner Circle Investments.

Noteworthy of the financing was the bifurcation of the land and hotels so that only the land was financed at the time. The hotels themselves will be refinanced at a later date. This type of land loan can be done at a 4.5 percent interest rate, as opposed to the typical 4.75 percent rate for hotel financing, says Shah.

Timing is everything

The market is currently experiencing a flat yield curve environment, according to Shah, which he believes is the best time for owners of hotels and other commercial real estate properties to put permanent debt in place. (When the yield curve flattens, the spread between shorter- and longer-term bond yields shrinks.)

"My prognosis is that by the same time next year, the debt yield is going to be higher," he says. "Lenders are going to pull back leverage." (Debt yield is a property's net operating income divided by the total loan amount. The higher the debt yield — usually expressed as a percentage — the less likely the borrower is to default on the loan.)

Gauge worth watching

One metric that investors and owners really focus on is the revenue per available room (RevPAR), which takes into account both room rates and occupancy. "It's a way to easily measure how well a hotel's performing from a revenue standpoint and potentially from a profitability standpoint," says Nate Sahn, senior vice president with CBRE Hotels in Chicago.

Year to date through September, RevPAR averaged $99.20 in Chicago, down 1.4 percent from the same period a year ago, according to STR.

Why sales volume has fallen

When marketing a hotel for sale, Sahn says CBRE also looks at the property's condition, how many renovations are required and any rebranding opportunities. In particular, CBRE looks for value-add opportunities because it knows that investors are keen on those types of deals.

Year to date through October, the total volume of hotel sales nationally was $23.3 billion, down from $30.6 billion the same period a year ago, according to Real Capital Analytics Inc. (RCA), which tracks property and portfolio sales $2.5 million and above.

Deal volume is down largely because there have been less portfolio trades and entity sales this year, according to Sahn.

Alexis Maltin, analytics manager at RCA, echoes this sentiment and says that single-asset sales are the truest measure of the health of the market. The volume of single-asset deals through the first 10 months of 2017 was $18.9 billion, down slightly from $19.4 billion year over year.

"While 2015 and 2016 seemed to be record-setting years for hotel volume, that pace was not sustainable and it looks like volume is slowly tapering off," she says. "This isn't necessarily something we should categorize as a decline, but more as a return to normalcy."

— *Kristin Hiller*