

## Condo Hotel Summary

What is a condo hotel: A condo hotel is a hotel where some or all the rooms have been legally transformed into condominium units which are sold to purchasers, and where it is intended that the condominium units will be part of the hotel's rooms inventory to be rented to the public and operated by the hotel management.

**The condo hotel concept provides significant advantages to the developer.** The traditional hotel developer has a long road between the time he envisions a project and the time he is able to realize a return on equity. The developer must obtain entitlements for the project, build it, open it, and then, typically after five years, stabilize the operation. Only then can the developer expect to see a return on investment or realize a profit through a sale or other liquidity event. Combined, this process can take seven years or longer from the start of the project.

A condo hotel developer can realize a substantial return on investment much earlier, because the profit margin from sales of the units usually close around the time the hotel opens for business. Additionally, the condo hotel developer has access to an additional source of secured financing: the pool of lenders that provide financing for traditional condominium development. This added source of capital can reduce lending costs. Further, the developer is the owner of the condo's hotel rental cash flow and can profit from a capitalization sale or re-financing.

For hotel developers, the condo hotel model is a financing bonanza. Construction debt for hotel projects typically runs 50 to 60 percent of cost. When condominiums are added to a hotel project, equity credits earned through condominium presales can provide debt financing approaching 90 percent loan-to-cost leverage. Developers are achieving significant front-end profits on the sale of condominium units in this scenario. And because the "hotel amenity" component creates a 15 to 40 percent premium value over the sale price per foot of comparable units, developers are also keen on the condo hotel model.

**The main topics for buyers of the individual condo hotel units are:** Rental revenue, appreciation, cash flow, financing and cost of ownership.

The rental revenue is shared with the hotel management company. No upfront fees are paid for this management. Instead, the management company takes a portion of the rental income that is generated. Although the revenue splits between owner and management company do vary from project to project, most hover around the 50/50 mark.

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Condo hotels are strategically located in resort settings and urban destinations with reliable demand for occupancy, which command consistently higher rates for the nightly stays and are almost always marked by high year-round occupancy. This combination of high nightly rental rates and high year-round occupancy rates make it possible for condo hotels to have very desirable cash flows.

In addition to the rental revenue that is generated, the appreciation that condo hotels typically experience are higher, as well. Many condo hotels have seen double digit growth, and have outperformed traditional condos or single family homes in the same market. A common question is whether condo hotels can be resold like normal real estate. And the answer is yes. Condo hotels are fee simple deeded real estate. You buy and sell them just like you would any other form of real estate.

Another common question revolves around financing for the individual buyers of condos and whether favorable rates can be attained. And the answer is yes. Financial institutions make loans on condo hotels and they are typically generally as similar to loans that can be found for a traditional vacation home. Most condo hotel developers make arrangements with specific lenders so that they may offer their clients the most favorable rates.

There are additional tax benefits of owning a condo hotel over a traditional condo. If the condo hotel is used for non-primary residence or residential rental, owners may be able to accelerate the depreciation on their condo hotel unit from 39 years, down to 27.5, 15, 7, and even 5 years.

Condo hotels have significant advantages that will endure. They are an excellent solution for people who want the overall cost of ownership reduced and still enjoy part-time-use of their condo unit and don't want to leave the unit vacant or hassle with renting it. Condo hotels also provide the developer the opportunity to obtain a return of equity earlier than would be available in a traditional hotel development. These benefits are likely to continue to be very attractive until a better model is devised.

**Source:** *John Sears is a partner with Boutique Hotel Advisors. A career hotelier, professional consultant and facilitator whose pedigree includes Mobil awarded five-star hotel management, nominated to the hospitality advisory board of Lynn University's School of Hospitality, Boca Raton, and authoring 'Five Star' the hoteliers guide to uncompromising service. John visits over 200 hotels per year and has a balanced background in operations, marketing, negotiations, development, property evaluations and acquisitions of luxury condo hotels and resorts.*

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