Luxury Hotel-Centered Mixed Use Projects: Value in the Mix

By: Bob Voelker

The days of stand-alone luxury hotels in urban areas are mostly gone. The vast majority of new premium hotels are key components of large mixed-use developments, with a combination of luxury condominiums, condo hotel rooms, fractional or vacation ownership units, high-end retail, office space, entertainment or trendy dining, and even apartment rental housing. Two major factors have forced this evolution: escalating development costs and the synergistic value added by the mixture of uses.

Land costs in major cities at $150-$1,000 plus per square foot and high construction costs involved in creating luxury finishes and furnishings have made developing a stand-alone luxury hotel a financially risky proposition. Developers, equity partners and lenders are all interested in reducing construction and permanent debt as quickly as possible to minimize this risk. For-sale components of the development (condominiums, condo hotel, fractional or vacation ownership), and steady income generators such as retail space and rental apartments that can be easily valued and sold to ready buyers shortly after construction completion allow developers to reduce guaranteed debt on the overall development, lower loan-to-value exposure for lenders and provide early returns on equity for investors, particularly when compared to the seasoning that is required for hotel property cash flow. Many lenders and equity investors will no longer consider any new luxury hotel that does not have a significant mixed-use component.

Synergistic value is created in mixed-use developments in several areas. First, hotel developers can add ‘sex appeal,” more dynamic 24-hour uses and marginal dollars to the overall cash flow from the real estate by expanding the base of hotel revenue beyond weekday business travelers to capture the leisure traveler seeking a long weekend hotel "experience" and the local retail, restaurant and entertainment audience. The mixture of components complement each other, enhancing cash flow by cross-feeding revenue streams. In addition, luxury residential condominiums and apartments attached to a premium hotel often earn a 25% to 40% premium as opposed to stand-alone residences. In addition, having the "rich and famous" living in the condominiums provides glamour to the hotel. Overnight guests, permanent condominium residents, apartment residents and local visitors all benefit and will pay higher rates or prices to stay or live near Rodeo Drive-type retail, the most sought-after local restaurant or the hottest nightclub located in the mixed-use development. In the present era of historically low cap rates driving record real estate prices, substantial value arises from the multiplier effect of added revenue dollars driven by the hotel-centered mixed use project.

The W Hollywood Hotel and Residences and Legacy Apartments, now under construction at the world-famous intersection of Hollywood & Vine (on the “Walk of Fame”), is a perfect example of high land and development costs necessitating a creative value-added solution. This unique urban redevelopment is a transportation-oriented, urban densification mixed-use/mixed-income project utilizing a combination of city assistance, private developer and investor capital and private and public (both state and federal) financing.

The development by Gatehouse Capital and Legacy Partners contains a Metro (subway) station, a 305-room luxury W hotel, 143 condominium residences, 375 apartment units, 30,000 square feet of advertising signage attached to the hotel, condominiums and apartments and 50,000 square feet of retail (including a health spa, high energy nightclub, pool bar and high profile restaurant) – all on 4.6 acres overlooking the Hollywood hills. The developers worked with the Community Redevelopment Agency of Los Angeles and the Los Angeles County Metropolitan Transportation Authority for over 5 years before construction began in April.

From a development and legal standpoint, these dense mixed-use urban projects are the epitome of real estate in the 4th dimension – being horizontally and vertically integrated makes the projects 3-dimensionsal – with the 4th dimension being a combination of added time and complexity. For the creative and patient developer and investor that are willing to persevere through a multitude of challenges, the rewards are significantly reduced financial risk and greatly enhanced value for all component parts of the development.

Bob Voelker is the head of the Munsch Hardt Hospitality, Condominium and Mixed Use Group*. Over the last 3 years, the Hospitality Group has worked with developers on the W Hollywood hotel and condominiums; W Dallas hotel and condominiums; Hotel Palomar hotel and condominiums in Dallas; Stoneleigh Hotel and condominiums in Dallas; Centrum Tower office, retail and condominiums in Dallas; Houston Pavillions condominiums, office and retail; the So-Co Urban Lofts in Dallas; and the Westin St. Maarten condo hotel in the Netherland Antilles; and is currently working on hotel/condominium transactions in Dallas, Houston, Milwaukee, Los Angeles, Gulf Shores (AL), Panama, Costa Rica and Mexico.
