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Back to basics: Boston hotel development moving in a different direction

November 18, 2010 - Front Section

In the 1980's it was the Bostonian Hotel, Boston Harbor Hotel and Swiss Hotel. In the early 2000's it was the "new" Ritz, Intercontinental, Renaissance, Liberty, Fairmont Battery Wharf and "W." In order to justify construction costs, Boston's newly constructed hotels had to be first class, full service, four star hotels that would command top of market average room rates. A condominium component was added to the project affording investors the opportunity to get their equity out of the project (in theory) and lay most of the operating costs off to the hotel. Beautifully designed hotels were constructed. Unfortunately, investment returns haven't quite measured up to projections.

In this next construction cycle, Boston will follow Manhattan for the type of newly constructed hotels. O'Connell Hospitality Group (OHG) believes that dollar for dollar, the best performing hotel investments will be newly constructed, upscale, select service hotels built on small "in-fill" sites around Boston. Thousands of hotel rooms have been built in Manhattan during the worst economic times, most of which are this type of product. Rooms-only operations with little or no food and beverage/meetings business is a profitable business model that works very well in urban settings. OHG represented the owner/developer of a 114 room Holiday Inn Express on 45th and 5th. The asset sold for $35 million ($307,000/room) and had 4 guest rooms per floor!

The size and scope of these hotels runs 100 - 150 guest rooms, 10 stories and typically can fit on 6,000 s/f lot. The construction costs associated with this size project run $250 per s/f. With average hotel room rates projected to increase dramatically, it's time to refocus on new construction today, in order to permit, construct and open in 2012/2013. This will be the perfect time for new supply to enter the market as the economy and therefore hotel demand surges to new highs during the next 18 to 24 months.

OHG has studied the neighborhoods of Boston and determined the best type (most profitable) of hotels to be permitted and constructed. We have conferred with the various development teams from the major hotel brands to insure their availability. Our findings show an extremely large segment of hotel room demand is underserved in Boston. Now is the time to begin preparing for the upswing in room demand and rates. As the economy improves, construction materials and labor will increase, pressuring investment returns.

There is evidence of this phenomenon already taking hold in Boston. A +200 room Residence Inn (extended stay suites) is proposed for Congress St., South Boston. A smaller, similar type hotel is proposed for the Fenway area and a smaller, limited service Hampton Inn is proposed by Cleveland Circle. There has been much discussion regarding a 1,000 room hotel required by the BCEC, however, without subsidies from the city and state, the costs associated with constructing this project cannot be justified when comparing anticipated future hotel room rates for conventioneers. Land costs in that area prohibit small hotels of the size and scale discussed herein being constructed in the Seaport District. Conversion of loft or office space typically isn't feasible as higher investment returns can be achieved for residential or office uses.

According to Pinnacle Realty Advisors of Boston and Smith Travel Research, 2010 Year to Date September performance in Boston has pushed occupancy rates above 75% and rooms rates well above $200 per night. Based upon a typically strong October and a weak November/December, these levels are where Boston should end up for the year end. The gains increased +15% over 2009 and were primarily achieved by increased occupancy as leisure demand has some back strong. Now that Boston has crossed the 75% occupancy threshold, hoteliers will begin to be much more aggressive with room rates and drive up prices. PKF Consulting projects +7% increases in room rates in 2011, however we expect Boston to experience double digit increase in 2011 and 2012. As room rates increase at large full service hotels, the upscale, select service hotels will push rates higher as well. However, since these hotels do not have the overhead and expense structure of four star hotels, the increased revenue will drop directly to the bottom and profits will surge.

Lastly, there is debt available for these types of projects. As performance improves, risk is assuaged and lenders/appraisers will buy into the projection and development story. The most important thing to do is act today before construction costs and competition place burdens on performance. So, as the big home improvement chain store says, "C'mon, let's build something together!"

O'Connell Hospitality Group, LLC, (OHG) was formed in 2000 and has grown to become one of the nation's top real estate firms specializing in hotel investment transactions. In that time, O'Connell has presided over more than $2 billion of hotel investments ranging from oceanfront resorts, major urban hotel projects and suburban, upscale-limited service hotels.

Previous to OHG, James O'Connell was senior managing director for Insignia ESG/Hotel Partners and ran the hospitality practice in the northeastern U.S. region. He is a proud alumnus of RECOLL Management Corp., where he managed hotel dispositions from the failed Bank of New England, an active member of the International Society of Hospitality Consultants, and a REFA sponsor and he is a 1982 graduate of Massachusetts Maritime Academy.