LEADERS IN HOSPITALITY TALK ABOUT WHAT'S HAPPENING ON THE FRONT RANGE

The hospitality sector in Denver is thriving and several new hotels have opened downtown recently. Is the boom sustainable? How does Denver compare with the rest of the nation in terms of revenue, room rates and occupancy levels, and what can we expect to see in the future?

Question: How is the current construction boom in Denver and the shortage of skilled craft labor affecting hospitality development?

SCOTT CONRAD, Swinerton Builders: Part of the challenge that we are facing in the current construction boom is that two of the healthiest sectors – hospitality and multifamily – use many of the same subcontractors, putting pressure on both markets. Swinerton does a few things to hedge the skilled craft labor shortage: First, our subcontractor prequalification process goes beyond evaluating the subcontractor's financial wherewithal and prior history; we closely analyze other aspects like manpower availability, crew sizing, previous project experience and reference checking to ensure all of our subcontractors have the resources necessary to build and staff a project. A second thing we do is build appropriate conservatism into our project schedules. For example, as a result of the thin labor market we may increase the schedule duration by 10 percent in order to set realistic expectations for the client. We present real information about market conditions, not just what the client wants to hear.

STEVE COHEN, Otten Johnson: One observation is that contractors (together with architects and other design professionals) are in such high demand right now that they have more leverage to push back on contracts, both from a business and legal standpoint. In the past when those same service providers may have been begging for work … they wouldn't necessarily have had the same negotiating power that they currently have. That goes to some of the points that Scott is mentioning, including the ability for a contractor to argue the need for its construction contract to contain a more conservative construction schedule based on lack of availability of manpower, etc.

WILLIAM "BILL" SIPPLE, HVS Capital Corp: One of the positives of a labor shortage is that the higher costs and the increased time on projects is a natural governor to supply growth.

Q: What are your general observations about the current level of supply and demand in the metro Denver lodging market?

MIKE CAHILL, HREC - Hospitality Real Estate Counselors: In 2014, metro Denver's occupancy of 75.4 percent was 17.1 percent higher than the national average. Today we're seeing occupancy growth of 2.2 percent from June 2014. Denver's RevPAR (room revenue per available room) grew 16 percent in 2014 from 2013, far outpacing the national average percentage growth of 8.3 percent. Denver was one of only two markets in the top 25 to rank in the top third for percentage growth in 2014 in occupancy, average daily rate and RevPAR. Things are very strong – the big picture is that Denver metro area is thriving.

Q: What are your thoughts about the Denver hospitality market going forward, from a macroeconomic perspective?

BENJAMIN "BEN" KURUVILA, U.S. Bank: US Bank is still very bullish on Denver, especially the CBD (Central Business District) and DIA. In both of those submarkets you see occupancies in the 85 to 90 percent range, so there's opportunity for new supply. We're not underwriting to those upper 80 percent ranges, but we're also not underwriting to national averages of 65 percent. Yes, Denver is going to soften eventually, but we're expecting it to plateau at somewhere around a 75 percent range. Historically Denver would have been more of a national average type market. It has outperformed the national average in recent years as Denver has become more of a tier 1 city.

CAHILL: When you take a step back – because we sell hotels all over the country – and you look at Denver, there are different groups of buyers out there. We may take an institutional first-class property to market here in Denver and have 120 people looking at it. We may lose half of that – the nervous nellies who are worried about new supply, but there are a lot of other people in the United States saying Denver is a great place to have my money. It's diversified and has so many great things going for it. But it depends on the type of buyer. A value-added flipper is not going to get a call about downtown Denver right now.

Q: Several new hotels have opened recently in downtown Denver, including Hyatt Place and Hyatt House, Renaissance, Crawford Hotel and Aloft, with more under development. At what point does supply exceed demand in the downtown market?

CHRIS MANLEY, Stonebridge Cos: One thing that's pretty impressive is that downtown grew occupancy by 2.2 percent (from June 2014 to June 2015) despite the headwinds of the oil and gas industry, which has a tremendous presence downtown and softened considerably in the last 12 months. That just goes to the fact that it's exciting to be downtown, with all the amenities. This is a place people want to be.

COHEN: There's no arguing that the hotel sector looks great right now from the operational side and it seems likely that the positive news will continue for some period of time. As Chris points out, occupancy continues to grow, and operators are continuing to see positive rate increases. I think the real issue from an investor's perspective is whether all of this positive news is too good, causing hotels to be overpriced in some instances. Among my clients, I believe there is a real question as to whether now is the right time to be a hotel buyer in light of the high prices that hotels are selling for.

SIPPLE: That translates into the debt markets, too. Lenders are much more concerned with supply growth than they've ever been, and they're trying to underwrite it and get a handle on it. What you're seeing is that supply growth is going to translate into higher debt costs in the marketplace.

Q: Anything new about your criteria in successfully underwriting a hotel construction project in metro Denver?

KURUVILA: On the construction side, the lending market for hospitality has remained constrained and conservative throughout this cycle. Many banks were hurt by hospitality through the downturn, so now hospitality construction financing is sponsor-driven. Lending constraints will only increase as banks wrap their arms around increased regulation. On the term lending side, that's a much more fluid space.

COHEN: It certainly seems better to be a borrower these days than it was three or four years ago, and I think there is more available debt (and better pricing for borrowers) that goes directly to the bottom line for underwriting purposes. I'd note that it's also better to be a borrower's lawyer than it was just a few years ago. All of sudden, you can actually have some discussions about certain provisions of the loan documents that you might not have raised when there were so few lenders making hotel loans. A few years ago a client might have said: "Don't push too hard on this. We don't want you to blow this deal because we don't have a lot of other lender options." It seems to me that now borrowers (and their lawyers) have a bit more swagger. It's still conservative underwriting, but at least the lenders are engaging more discussions. It's all becoming a bit more balanced.

Q: Is the nature of the hotel product in Denver changing, given the current supply and demand trends?

SIPPLE: You're seeing a better acceptance in the Denver market than a lot of other markets with boutique-type projects. That's one of the things about Denver and goes to the whole nature of what Denver is about and what people are looking for… such as the number of people who want to live downtown. And it's not just millennials.

Q: When can we expect more of these lifestyle brand names to come here and be successful?

MANLEY: Consumers over the next 24 months are going to be presented with many new options in lifestyle brands, which are unique, cutting-edge, and trendy. It's the AC (Marriott), the Canopy (Hilton), the Curio (Hilton) collection. The brands have expanded their offerings to attract new types of customers. Everyone is targeting millennials, who have a growing amount of wealth and a propensity to spend it on travel.

KURUVILA: Everyone is looking for an experience. I don't think the millennial traveler is looking for the exact same hotel in each city. They want something unique – something that's "the great hotel in Denver." … As a lender, there's added risk to financing a boutique flag – less robust reservation system, less national data to rely on, and lack of nationally recognizable flag. But some of these lifestyle brands that the major flags are starting to distribute – we're getting more comfortable with those.

Q: We are seeing more "dual brand" hotels. Are there unique design or construction characteristics to be considered with these types of properties?

MANLEY: The dual brand is a trend we're seeing, especially in urban markets like downtown Denver where land is very expensive. We brought the first dual brand to downtown Denver at 15th and Welton – a combination Hampton Inn and Homewood Suites. Three hundred rooms would have been too much supply for one particular brand, but by bifurcating it into two distinct brands, we can offer different price points, different service levels and different products than we would have with a single hotel. You have benefits on construction because you share back-of-house, elevators, common areas and amenities, which lowers your construction cost per room.

CONRAD: Our most recent hotel projects have both been dual branded – the Hyatt House and Hyatt Place and 14th and Welton, and next month we break ground on the Starwood Le Meridien and the Marriott AC Hotel at 15th and California. Not only are high-rise hotels in urban settings a fun challenge to build, we partner with our clients to deliver those shared back-of-house spaces Chris (Manley) mentioned to help the overall development pro forma.

Q: Is hospitality in Denver at a point where it can be considered another accepted asset class for institutional investors?

MANLEY: The availability of capital now for hospitality, be it debt or equity, has increased substantially. It used to be that institutional money wanted one of the four food groups – office, industrial, multifamily or retail. Hospitality was this awkward asset class that had a perceived risk people wanted to stay away from. Now, whether people are looking for yield, or whether they're getting more comfortable with the fluctuations or volatility of cash flow, you're seeing more people look at hospitality than would have looked at it in previous cycles.

CAHILL: You have to look at the big picture. What you're seeing now is that lenders are active, but even though interest rates are low, they are much more disciplined. That's constrained supply and has fueled RevPAR growth. So between increasing construction costs and lenders remaining disciplined, overall new supply is not as near as bad as it's been in past cycles, which is good for Denver.

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Deep roots reach higher.

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30
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