

COMPASS

Navigating the Minneapolis-St. Paul Commercial Real Estate Market



HOTEL MARKET

Despite Expected “Cooling,” Twin Cities Hotel Market Boasts Strong Demand

Following eight years of unprecedented growth, the Twin Cities hotel market has finally leveled off and is flying at “cruising altitude.” Buoyed by a healthy economy, demand is strong by both business and leisure travelers. While demand remains strong, supply growth has slowed due to the amount of recent new development and increasing financing and construction costs. It may take time for the market to fully absorb new supply, but average occupancy in June was still 79.5% metro-wide, and 80.5% in the Minneapolis CBD, representing 0.6% and 1.9% increases over last year, respectively. Revenue per available room (RevPAR) for June, meanwhile, increased year-over-year 2.4% for the metro and 4.8% in the Minneapolis CBD, showing that the market is absorbing new supply well.

Approximately 4,450 rooms have been delivered in this cycle, and more than 7,000 additional rooms are in some stage of planning or development. Rates continue to climb due to demand growth while RevPAR growth has remained solid. It has been a long, healthy cycle, and as long as the economy remains strong, the hotel market is expected to remain on solid footing.

SUPER BOWL WAS A BIG WIN FOR HOTELS

The market got a big short-term boost from Super Bowl LII. Minneapolis-St. Paul area hotels boasted the highest RevPAR increase for a Super Bowl host market since Indianapolis hosted it in 2012. Between Feb. 2 and 4, the market posted an average occupancy level of 92.5% and an ADR of \$354.41. As a result, RevPAR jumped 626% compared with the same three days in 2017, according to STR Global.

DEVELOPMENT BOOM IS NOT OVER, BUT A SLOWDOWN IS PROJECTED

Development remains robust with 7,200 rooms in some stage of planning or development. Developers continue seeking prime sites for the “right flag in the right market.” Some have shied away, however, not wanting to develop at the top of the cycle. Also, rising construction and financing costs are creating additional barriers to new construction. A slowdown in new development is anticipated.

Downtown Minneapolis: Market continues to thrive with 1,900 new rooms proposed or underway. Big national events, including the NCAA Men’s Final Four in 2019, are helping fuel demand.

Projects include:

- JR Hospitality and Hawkeye Hotels, which have 11 local projects in the works, are planning a 115-room Cambria Hotel and a 200-room Fairfield Inn at 41 10th St. N.

HOTELS % CHANGE YTD JUN 18 vs. JUN 17						Source: Smith Travel Resource	
	OCCUPANCY	ADR	REVPAR	ROOM REV	ROOM AVAIL	ROOM SOLD	
United States	1.0	2.7	3.8	5.8	2.0	3.0	
Minnesota	3.4	6.8	10.4	12.7	2.1	5.6	
Mpls-St. Paul, MN-WI	3.1	9.7	13.1	16.7	3.2	6.4	
Duluth, MSA	4.5	-0.6	4.0	6.9	2.8	7.5	
St. Cloud / I-94 Corridor	4.0	2.5	6.6	6.5	-0.1	4.0	
Rochester (MN)	9.1	3.0	12.4	13.4	0.8	10.1	

HOTELS YTD JUN 18 vs. JUN 17

Source: Smith Travel Resource

	OCCUPANCY %		ADR \$		REVPAR \$	
	2018	2017	2018	2017	2018	2017
United States	65.9	65.3	129.36	125.90	85.29	82.20
Minnesota	60.2	58.2	115.53	108.17	69.50	62.95
Mpls-St. Paul, MN-WI	66.5	64.5	124.17	113.22	82.54	73.00
Duluth, MSA	57.0	54.5	114.09	114.73	65.01	62.53
St. Cloud / I-94 Corridor	55.7	53.5	96.86	94.53	53.96	50.62
Rochester (MN)	65.7	60.2	114.16	110.83	75.05	66.76

Downtown St. Paul: Market continues to heat up, with approximately 500 new rooms underway or proposed.

Projects include:

- Kaeding Management is developing a 109-room Residence Inn at Leech Street and Grand Avenue.
- Raymond Management is under construction with a 186-room SpringHill Suites at 472 Jackson St.
- Jim Crockarell has proposed a 129-room Marriott Tribute hotel in the Park Square Building near Mears Park.

Bloomington/Mall of America/Airport:

Market is booming with about 1,800 rooms planned or underway.

Projects include:

- Baywood Hotels is planning a 100-room Tru by Hilton and a 105-room Home2 Suites at 2405 Old Shakopee Road.
- JR Hospitality has proposed a 150 guestroom Hyatt Place at E. 86th St. and Old Shakopee Road.

LIMITED SERVICE, EXTENDED STAY HOTELS REMAIN HOTTEST SECTOR

The majority of new development is

occurring in the limited service and extended-stay categories in the upper midscale to upper upscale segments, which comprise 76% of new supply nationally. Developers are attracted to the higher operating margins and lower development cost for these types of properties. Dual-brand hotels are also becoming popular as developers look to limit competition and increase efficiencies by combining multiple brand offerings on a single piece of land. A frequent example is Home2 Suites and Tru by Hilton, similar to what is anticipated near the Mall of America.

PACE OF TRANSACTION ACTIVITY SLOWED DUE TO LARGER 'BID-ASK SPREAD'

It remains a seller's market but values may be topping out. Also, investors are more selective and cautious. There is still a large pool of buyers seeking prime hotel assets in desirable submarkets -- if they can find the right asset at the right price. However, there is a widening buy-sell gap that has slowed transaction activity.

Notable sales:

- Hospitality Properties Trust purchased

the Radisson Blu in Downtown Minneapolis from Chartres Lodging Group for \$75 million.

- AIG Global Real Estate Corp. acquired the DoubleTree by Hilton near the University of Minnesota from Huron Investors LLC for \$38.3 million.
- A private investor purchased the Four Points by Sheraton in Richfield from GM Richfield LLC for \$12.8 million.

OUTLOOK

The next six months will likely see continued positive growth as the result of a strong economy and an anticipated strong summer travel season. There is no foreseeable sign of a downturn.

Demand should remain solid. With the demand, rates will continue to climb; however, rate growth could temporarily slow in some submarkets due to the influx of new rooms being delivered.

Investor interest will remain strong for prime assets in attractive submarkets. Development is expected to slow due to overbuilding concerns and increasing construction and financing costs.

ABOUT THE AUTHOR

THE COMPASS REPORT

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3500 American Blvd W Suite 200
Minneapolis, MN 55431
952 831 1000 | cushmanwakefield.com