CUSHMAN & WAKEFIELD

JULY 2019

COMPASS

Navigating the Minneapolis-St. Paul Commercial Real Estate Market

HOTEL MARKET

Supply Catching Up to Demand

Although demand for hotel rooms continues to climb in the Twin Cities, heavy supply levels are starting to catch up to demand.

Supply growth in the metro increased an average of 3.1% in the past 12 months, while demand increased an average of 0.6%.

The hospitality sector enjoyed a long hot streak with a surge in new development. Approximately 6,500 rooms were delivered metro-wide during this "up-cycle" and another 6,700 rooms are in the construction pipeline.

HOTELS YTD JUN 19 vs. JUN 18 — Source: Smith Travel Resource

	OCCUPANCY %		ADR $		REVPAR $	
	2019	2018	2019	2018	2019	2018
United States	65.9	65.9	131.20	129.72	86.51	85.45
Minnesota	59.3	60.1	113.18	115.84	67.07	69.65
Mpls-St. Paul, MN-WI	64.9	66.5	119.77	124.27	77.71	82.61
Duluth, MSA	54.7	57.0	117.17	114.24	64.11	65.08
St. Cloud/I-94 Corridor	53.7	54.7	100.93	99.92	54.22	54.68
Rochester (MN)	65.3	66.1	116.77	114.76	76.26	75.84

HOTELS % CHANGE YTD JUN 19 vs. JUN 18 — Source: Smith Travel Resource

	OCCUPANCY	ADR	REVPAR	ROOM REV	ROOM AVAIL	ROOM SOLD
United States	0.1	1.1	1.2	3.3	2.0	2.1
Minnesota	-1.4	-2.3	-3.7	-1.2	2.6	1.1
Mpls-St. Paul, MN-WI	-2.4	-3.6	-5.9	-3.0	3.1	0.6
Duluth, MSA	-4.0	2.6	-1.5	-0.1	1.4	-2.6
St. Cloud/I-94 Corridor	-1.8	1.0	-0.9	3.7	4.6	2.7
Rochester (MN)	-1.2	1.8	0.6	0.7	0.1	-1.0

The hotel business follows the economy, and the economy remains healthy, fueling both leisure and business travel. However, given the cyclical nature of the sector – and the fact that it has been at the top of the cycle for so long – a downturn is inevitable. But when and how deep is unknown. As long as the economy remains strong and there is no major global event, the sector could merely be headed for a "blip."

Comparing 2019 data to the Twin Cities' Super Bowl host year in 2018, the market reported in June a 3.6% year-to-date decline in average daily rates (ADR) to $119.77, and a 5.9% drop in revenue per available room (RevPAR) to $77.71. Average occupancy fell 2.4% to 64.9%. The market in 2018 was buoyed by the Super Bowl (with some 125,000 visitors), ESPN's X Games, the WNBA All-Star Game, and other major events. This "Super Bowl effect" is still in play, skewing the numbers. (It should be noted that demand for rooms increased 4.6% for the NCAA Men's Final Four in Minneapolis in March 2019.)

Despite a slew of new rooms delivered, construction remains solid. Developers continue pursuing key sites, if they have the right flag for the market. However, increasing construction/labor costs and the limited availability of flags are curbing new construction. Amid overbuilding concerns and rising costs, some developers tapped the brakes, which will slow future supply growth.

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DEVELOPMENT ACTIVITY

Downtown Minneapolis continues seeing robust development, with a construction pipeline of roughly 1,700 rooms, including United Properties' 180-room Four Seasons Hotel & Resorts in the Gateway Tower development, which will be the metro's only five-star hotel. **Other projects include:**

- United Properties and Lion Group are developing the 156-room Element by Target Field – the metro's first Element.
- Graves Hospitality and Basant Kharbanda have opened the 150-room Moxy Minneapolis Downtown.
- Sherman Associates completed the 183-room Canopy by Hilton.
- Maven Real Estate Partners is adapting the historic Rand Tower into a 270-room Tribute by Marriott hotel.

Downtown St Paul's hotel market continues to heat up, with approximately 1,100 new rooms in the pipeline. **Projects include:**

- Raymond Group is developing the 186-room SpringHill Suites at 472 Jackson St.
- Rebound Hospitality is converting the Exchange Building into the 71-room Celeste St. Paul Hotel + Bar.
- Drury Hotels Co. is converting the former Embassy Suites by Hilton into a 208-unit Drury Inn.

Bloomington/Mall of America/Airport remains a hot spot, with roughly 1,200 new rooms in the pipeline. **Projects include:**

- JR Hospitality and Hawkeye are developing the 151-room Hyatt House near Mall of America, the brand's first Minnesota location.
- Terratron is building a 142-room Element by Westin near Mall of America.

Other hot markets include Woodbury, Maple Grove, Brooklyn Park, and Shakopee.

LABOR, RISING COSTS IMPACT SECTOR

Hotel operators are concerned with the availability of labor and rising wages. Operators also face increasing costs of supplies and materials, all of which impact their bottom line.

CAPITAL CHASING HOTELS BUT AVAILABLE PRODUCT LIMITED

Well-located metro properties are still highly sought after, and in many cases there are multiple bids. But there are also more buyers than sellers. Since construction/material costs continue increasing, owning an existing hotel is often considered more attractive than building new. The value of Twin Cities hotels is expected to remain strong given the solid market fundamentals. **Notable sales:**

- Apple Hospitality REIT acquired the Hampton Inn & Suites St. Paul from Vhrmr Minn LLC for $31.69 million.
- Titanium Partners purchased La Quinta Woodbury for $11.4 million.
- K&K Hotel Group purchased the former DoubleTree Brooklyn Center from Boxer Resorts for $10 million and converted it to a Radisson.

LIMITED-SERVICE, EXTENDED-STAY, DUAL BRANDS DOMINATE CONSTRUCTION

Due to increasing construction costs and competition for guests, brands' lower-cost flags are helping make new development and conversions viable. Examples include Marriott's Moxy; InterContinental Hotels Group's Avid, Home2 Suites and Tru by Hilton; and Westin's Element.

Dual-brand hotels also remain hot, as developers seek to streamline costs by combining multiple concepts under one roof. Home2Suites and Tru by Hilton is an example.

OUTLOOK

Following several years at peak levels, a slowdown is inevitable, but when and how deep is unclear. The sector still demonstrates solid fundamentals and continues expanding and will follow the economy. Upcoming events including the X Games in 2019 and 2020 will help drive demand.

The hotel-construction pipeline is active yet has cooled. Fewer new rooms should allow occupancy to remain relatively stable.

Investor demand is expected to remain robust for prime properties in strong-performing markets.

ABOUT THE AUTHOR

THE COMPASS REPORT

ABOUT CUSHMAN & WAKEFIELD

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