

Hotel Conversions – a creative approach to multifamily

By: Kyle Hauge



Multifamily investors and operators have seen asking prices for apartments continue to soar due to increased competition and a seller's market, especially in red hot markets like Arizona and Texas. Meanwhile since COVID, many hotels have been hit hard with vacancy losses, staff losses and other hardships which has led to a much more depressed market for sales to other potential hotel owners. Hotel occupancy hit a record low of 22% in April of 2020. Since that time certain multifamily operators and investors have recognized this unique opportunity in the marketplace to turn a distressed asset into a high performing real estate investment.

The ability to successfully convert a hotel into a multifamily apartment requires a significant amount of research, expertise, and creativity, but when done well it can enable an operator to acquire a future multifamily property at a steep discount in high demand markets. In most cases the asset will be in better condition after renovations and upgrades than a comparable multifamily property. Per STR.com, research indicates a full recovery in the hotel industry by 2024, which means a window of opportunity.

There are unique challenges that come with a hotel conversion, primarily ensuring property zoning requirements and permits are met for the renovations, adding kitchens and enlarging room sizes, ensuring hotel franchise agreements are terminated and estimating costs and rehab time. This is why partnering with an experienced operator is key, especially one with local contacts, vendors, construction knowledge and relationships with city planners. As well as a construction team with previous success and expertise to create the ideal design for the newly renovated property.

At Saber Equity, we have been an early proponent of this strategy and would like to share a quick case study on our Thunder Mountain Hotel Conversion project:

Case Study: 100 key hotel into 65 unit Multifamily



Location: Sierra Vista, AZ. A growing market an hour south of Tucson, home of the leading drone and cyber security military bases Ft. Huachuca, tourism, and it's blossoming tech hub. Currently experiencing a major shortage of multifamily housing.

Sponsor Team: Saber Equity is partnering with Bakerson, an experienced Phoenix based Multifamily operator who specializes in heavy lifts and renovations. We're also utilizing Asset Living as property manager and construction team, who has completed 6 successful hotel conversion in Arizona over the last 2 years.

Acquisition Details: The Quality Inn owner was selling his distressed 100 unit hotel, and it was purchased off market at \$1.75m, or \$17.5k per door.

Projected Renovation Costs: \$1.7m for both interior and exterior renovations.

Timeline: This property closed in May of 2021, and renovations are expected to be completed in 12-14 months. Upon stabilization, we will be implementing a refinance into permanent debt with the goal to return 60%+ of investors capital, with a subsequent refinance in year 4 to return remaining capital. Investors will continue to stay in the deal through long term hold.

Projected Returns: We're projecting a total return of 17.9% IRR, along with an equity multiple of 2.40. This will include a preferred return of 8% to investors, which is deferred during the construction phase with a catchup provision in year 2. Investors will also benefit from multiple refinances to return capital and a cost segregation study to maximize tax benefits.

Current Status: After successfully closing in May of 2021, demo and renovations are already underway and ahead of schedule. The local project manager and construction team are working hand in hand with the city and architects to keep the project on schedule and on budget. Half of the building is under construction, with the other half open for short term rentals to maximize income.

Proof of Concept and Comparable Property;

In 2020, the nearby Extended Stay in Sierra Vista was successfully converted into The Vistas Apartments, using the same local construction team.

Before:



After:





More pictures here: <https://www.thevistasaphomes.com/photogallery.aspx>

Summary: As discussed above, the hotel conversion strategy enables us to acquire an eventual multifamily asset at a significant discount; for comparison, the average multifamily in Tucson is selling at \$108k per unit through Q2 2021; whereas our total adjusted per unit cost of the renovated building, including repairs, will be \$53,292. Tenants will also enjoy a newly renovated building, amenities and a prime location in the city and we expect this to lease up quickly. Saber Equity continues to look for unique and cutting edge strategies to acquire quality, cash flowing assets for our investors and we will continue to research additional opportunities for hotel conversions.

Want to learn more or get involved? Contact our team to learn more about this project

Want to partner with us to invest in this project? Find out how, here:

<https://www.saberequity.com/thunder-mountain>

Stay tuned for more updates, features and advice on our current projects and future opportunities!

References: Yardi Matrix; Costar, Cushman & Wakefield, www.str.com,