

Novogradac Journal of Tax Credits

News, Analysis and Commentary On Affordable Housing, Community Development and Renewable Energy Tax Credits

March 2011, Volume II, Issue III

Published by Novogradac & Company LLP

The Boutique Hoteliers and Historic Preservation: What Are They Doing Today?

By John M. Tess, Heritage Investment Corporation

The hospitality industry has always played an important role in our nation's growth and the urbanization of the United State's small towns and large metropolitan areas. The industry itself is reflective of the increasing mobility of American society and the modes of transportation used by Americans since the country's inception. It is also reflective of the country's economic health. As a result, it is not surprising that the rehabilitation of hotels has played a strong role in the historic preservation movement since the beginning of the federal tax incentives for the rehabilitation of historic properties.

According to the National Park Service, (NPS), 5.6 percent, or 951, of the 16,894 projects approved from 1995-2010 were for hotel use. And, of the \$41.76 billion in approved Part 2 projects, 21 percent, or \$8.8 billion was for hotel use. (For reporting purposes, the NPS includes bed & breakfasts within the hotel category, although this is not thought to be a large number. Cumulative NPS statistics are also not available prior to 1995). Taking into consideration that these statistics represent only a portion of the projects that have made use of the 20 percent federal investment tax credit for historic properties and do not represent those eligible for use of the 10 percent credit, or those not using that credit, the numbers are significant.

A certain percentage of hotel rehabilitation projects involve the redevelopment of the "grand dame" hotel found in most major cities. Examples range from the Willard Hotel in Washington, D.C. to the Blackstone in Chicago to the Fairmont Hotel in San Francisco. In smaller cities, properties include the Davenport Hotel in Spokane and the Cincinna-



Photo: Courtesy of Heritage Consulting Group

A five-star hotel is planned for the bottom floors of Chicago's IBM Building.

tian Hotel in Cincinnati. More often, the boutique hotel is thought of as a converted downtown older office, warehouse or apartment building.

Since founding Heritage in 1982, I have had the privilege to working with many hoteliers over the years, including all

continued on page 2

continued from page 1

of the companies listed in this article.

Anyone in the hotel industry knows the concept of the boutique hotel in the United States was pioneered by Bill Kimpton. In the beginning Kimpton envisioned a niche of moderately priced "European-styled" hotels that would provide "weary travelers with a haven of comfort, service, security and style." In 1981 Kimpton began redeveloping existing small hotels or adapting older buildings in the San Francisco Bay area. His first project was the Bedford Hotel in downtown San Francisco. Over the years Kimpton Hotels expanded in selected markets across the United States and Canada, each time raising the bar of services and amenities.



Photo: Courtesy of Oxford Capital Group
Hotel Felix Chicago was the first hotel in Chicago to receive the Leadership in Energy and Environmental Design (LEED) Silver certification for commercial interiors from the U.S. Green Building Council (USGBC).

Pres Kabacoff, CEO of HRI Properties, claims credit to the first use of the federal historic tax credits (HTCs) in a boutique hotel. HRI began in 1982 and has developed 3,487 hotel rooms in the company's history. Other major boutique hotel developers include Sage Hospitality, Joie de Vivre, Standard Hotels and Thompson Hotels, among others.

Since the 1980s, historic and boutique hotels have proliferated, benefiting from both surging popularity in heritage tourism and renewed vigor in our urban cores. Early on, small hotels, apartments or office buildings converted well to boutique hotels with entry lobbies, vertical access and efficient floor plans. Time and again, these buildings proved to be economical to adapt, and cheaper than new construction. John Rutledge, CEO of Oxford Capital Group LLC, who had been involved in numerous hotel projects in the Chicago area including the rehabilitation of the Cass and Felix Hotels, feels that rehabilitation opportunities offer better "value-added development opportunities" than new construction, especially in a downturn economy. The success of the boutique hotel is unquestioned given that today boutique hotels are found in nearly every community. The renovation of historic hotels is reflected in the National Trust for Historic Preservation's Historic Hotels of America program, which lists 234 properties across the country.

continued on page 3

Novogradac Journal of Tax Credits Editorial Board

PUBLISHER

Michael J. Novogradac, CPA

MANAGING EDITOR

Alex Ruiz

EDITOR

Jane Bowar Zastrow

TECHNICAL EDITORS

Robert S. Thesman, CPA
 James R. Kroger, CPA
 Owen P. Gray, CPA
 Thomas Boccia, CPA
 Daniel J. Smith, CPA

ASSIGNMENT EDITOR

Jennifer Dockery

STAFF WRITER

Jennifer Hill

CONTRIBUTING WRITERS

| | |
|----------------------|------------------------|
| Thomas Boccia, CPA | Forrest Milder |
| Jing Chen, CPA | Lindsay Sutton |
| Brandi Day | Annette Stevenson, CPA |
| Brad Elphick, CPA | Amanda Talbot, HCCP |
| G. Tyler Gibbs, CPA | John M. Tess |
| James R. Kroger, CPA | Stephen B. Tracy, CPA |
| Peter Lawrence | |
| John Leith-Tetrault | |

PRODUCTION

Jesse Barredo
 James Matuszak

Novogradac Journal of Tax Credits Information

Address all correspondence and editorial submissions to:
 Alex Ruiz / 415.356.8088

Address inquiries regarding advertising opportunities to:
 Emil Bagalso / 415.356.8037

Editorial material in this publication is for informational purposes only and should not be construed otherwise. Advice and interpretation regarding the low-income housing tax credit or any other material covered in this publication can only be obtained from your tax advisor.



**NOVOGRADAC
& COMPANY** LLP

CERTIFIED PUBLIC ACCOUNTANTS

© Novogradac & Company LLP
 2011 All rights reserved.
 ISSN 2152-646X

Reproduction of this publication in whole or in part in any form without written permission from the publisher is prohibited by law.

Novogradac Journal of Tax Credits Advisory Board

LOW-INCOME HOUSING TAX CREDITS

| | |
|------------------|--|
| Bud Clarke | BOSTON FINANCIAL INVESTMENT MANAGEMENT |
| Jana Cohen Barbe | SNR DENTON |
| Tom Dixon | BOSTON CAPITAL |
| Valerie White | STANDARD & POOR'S CORPORATION |
| Rick Edson | HOUSING CAPITAL ADVISORS INC. |
| Richard Gerwitz | CITI COMMUNITY CAPITAL |
| Rochelle Lento | DYKEMA GOSSETT PLLC |
| John Lisella | U.S. BANCORP COMMUNITY DEV. CORP. |
| Phillip Melton | GRANDBRIDGE REAL ESTATE CAPITAL |
| Thomas Morton | PILLSBURY WINTHROP SHAW PITTMAN LLP |
| Stephen Ryan | COX, CASTLE & NICHOLSON LLP |
| Arnold Schuster | SNR DENTON |
| Rob Wasserman | U.S. BANCORP COMMUNITY DEV. CORP. |

PROPERTY COMPLIANCE

| | |
|----------------------|--|
| Rose Guerrero | CALIFORNIA TAX CREDIT ALLOCATION COMMITTEE |
| Sharon Jackman | SIG SERVICES LLC |
| Michael Kotin | KAY KAY REALTY |
| Michael Snowdon | MCA HOUSING PARTNERS |
| Gianna Solari | SOLARI ENTERPRISES |
| Ruth Theobald Probst | THEOPRO COMPLIANCE & CONSULT. INC. |
| Kimberly Taylor | HOUSING DEVELOPMENT CENTER |

HOUSING AND URBAN DEVELOPMENT

| | |
|-------------------|---------------------|
| Sheldon Schreberg | PEPPER HAMILTON LLP |
| Monica Sussman | NIXON PEABODY LLP |

NEW MARKETS TAX CREDITS

| | |
|-------------------|--------------------------------------|
| Frank Altman | COMMUNITY REINVESTMENT FUND |
| Bruce Bonjour | PERKINS COIE LLC |
| Neil Kimmelfield | LANE POWELL |
| Marc Hirshman | U.S. BANCORP COMMUNITY DEV. CORP. |
| Scott Lindquist | SNR DENTON |
| Ruth Sparrow | FUTURES UNLIMITED LAW PC |
| Herb Stevens | NIXON PEABODY LLP |
| Mary Tingerthal | HOUSING PARTNERSHIP NETWORK |
| Tom Tracy | HUNTER CHASE & COMPANY |
| Joseph Wesolowski | ENTERPRISE COMMUNITY INVESTMENT INC. |

HISTORIC TAX CREDITS

| | |
|---------------------|---------------------------------------|
| Don Holm | FARRIS BOBANGO BRANAN PLC |
| John Leith-Tetrault | NATIONAL TRUST COMM. INVESTMENT CORP. |
| Bill MacRostie | MACROSTIE HISTORIC ADVISORS LLC |
| Donna Rodney | BRYAN CAVE LLP |
| John Tess | HERITAGE CONSULTING GROUP |

RENEWABLE ENERGY TAX CREDITS

| | |
|------------------|-----------------------------------|
| Ed Feo | USRG RENEWABLE FINANCE |
| Michael Hall | BORREGO SOLAR SYSTEMS |
| Jim Howard | DUDLEY VENTURES |
| Forrest Milder | NIXON PEABODY LLP |
| Darren Van't Hof | U.S. BANCORP COMMUNITY DEV. CORP. |

continued from page 2

In the past decade, however, boutique hotels have faced severe challenges. The initial challenge was surprising; the so-called "back to the city" movement created strong demand for older urban buildings. Kimpton's Joe Long reports that over the years, buildings that would have been prime candidates for boutique hotel conversion became too expensive to convert in light of demands for downtown office and residential

space. This was especially true between 2003 and the real estate meltdown in 2008 when the condo boom took many buildings off the market for conversion or speculation. During that period, many hotel development companies focused on hotel management and in some cases looked to ground up development.

With the collapse of the economy in 2008, room and occupancy rates collapsed below sustainable levels. At the same time, room inventory continued to rise as developers with projects under construction had no choice but to complete them. With discretionary income down and employment insecurities up, tourism fell as well. Even developers who were looking to the next cycle could not proceed for lack of financing.

Today the consensus is that the hotel real estate market is returning. Room rates are beginning to rise and vacancy rates are beginning to fall. Many believe that things should return to normal by 2012 or 2013. A stronger economy, an increase in tourism and reduced construction costs are all factors playing a role in a healthier hotel environment.

In fact, as the markets continue to settle, Kimpton's Long says the he is seeing "old real estate deals that collapsed in 2008 being looked at again." While the investment market is still not keen on hotels, many hotel developers are ready to acquire existing properties to hold or for later redevelopment. One example of a new project is Kimpton's Lafayette Hotel rehabilitation in Philadelphia, where, interestingly, many larger buildings are being con-

This approach was just com-



Photo: Courtesy of Oxford Capital Group
The Hotel Cass is located in Chicago's Magnificent Mile corridor.

continued on page 4

continued from page 3

pleted in Chicago with Daniel Burnham's last designed building, the 1912 Continental and Commercial Bank, where the lower half of the building was renovated into a J. W. Marriott and the upper floors remained offices. Another similar project involves the rehabilitation of Chicago's Old IBM Building at 330 N. Wabash Avenue.

In this economy it is likely that in the next several years we will see a slow return in the rehabilitation of existing buildings for hotel use. Boutique hotels should pay a big role in this resurgence, given the increase of buildings available for rehabilitation, the value added opportunities they offer, their generally relatively smaller physical size and the potential to put together innovative financial structures. According to some, the hotel cycle moves from acquisition, to redevelopment of existing units to actual new construction. Given that we have just been

through one of these cycles the stage seems to be set for cycle to start over.

Thus, the outlook for the hotel industry in the coming years looks significantly better than other real estate sectors. As we all know, the condominium market continues its slow absorption in the face of foreclosures and underwater product. Central city office markets continue to sag as unemployment remains stagnant, perhaps providing other available building product for the hotel rehabilitation market. And, the apartment market, while strong, could change with a stronger housing market.

As our economy returns and the real estate market cycles forward, we anticipate that the boutique hotel will be a major component, and perhaps a bellwether of better things to come.

This article first appeared in the March 2011 issue of the Novogradac Journal of Tax Credits.

© Novogradac & Company LLP 2011 - All Rights Reserved

Notice pursuant to IRS regulations: Any U.S. federal tax advice contained in this article is not intended to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties under the Internal Revenue Code; nor is any such advice intended to be used to support the promotion or marketing of a transaction. Any advice expressed in this article is limited to the federal tax issues addressed in it. Additional issues may exist outside the limited scope of any advice provided – any such advice does not consider or provide a conclusion with respect to any additional issues. Taxpayers contemplating undertaking a transaction should seek advice based on their particular circumstances.

This editorial material is for informational purposes only and should not be construed otherwise. Advice and interpretation regarding property compliance or any other material covered in this article can only be obtained from your tax advisor. For further information visit www.novoco.com.

[Special offer for E-newsletter only subscribers:](#)

Click here for **20% off** an introductory
12-Month Print Subscription to the Journal of Tax Credits.