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New Converts in U.S.: Hotels

Developers Turn to Pre-Existing Office Space for Lodgings

By MELVIN BACKMAN

As demand increases for hotel rooms in the U.S. amid growth in tourism in some cities, developers are turning to pre-existing buildings to cut construction time and save money.

New York has seen a flurry of conversion projects, including the Knickerbocker Hotel in Times Square. It originally was developed as a hotel in 1906 and is being restored by [FelCor Lodging Trust](#) Inc. as a lodging after spending decades as an office building.

Other hotel conversions around the country include 59 Temple Place in Boston, which is being renovated from an office-and-retail property by Oxford Capital Group LLC, and the Peal Brewery, in San Antonio, which Kimpton Hotel & Restaurant Group LLC is converting into a 146-room hotel.

Oxford Capital, which has converted or restored nine Chicago properties into hotels, is moving ahead with its 10th project in the city. With partner Angelo Gordon & Co., Oxford is buying the 21-story London Guarantee Building for \$53 million and plans to convert the structure into a high-end hotel, which is set to open in 2015.

The trend highlights one of the changing dynamics of the commercial-real-estate industry. Hotels, which had been big losers during the recession, have rebounded and are profitable, while office property continues to lag behind due in part to slow jobs growth. That has been an especially big problem for older office buildings.

"The office market isn't thriving as much in some markets, so a conversion from an office building to a hotel is an attractive alternative," said Rachel Roginsky, founder of Boston consulting firm Pinnacle Advisory Group.

By converting buildings to hotels, owners hope the buildings will produce higher incomes and better returns on their investments.

In Chicago last year, Oxford converted the bottom fourth of the 52-story former [IBM](#) building, located at 330 North Wabash Ave., into a 330-room Langham Hotel, which opened in July.

John Rutledge, Oxford's chief executive, said his firm likes conversion projects because they can turn around properties faster than they would if starting from scratch.

"We can get property converted more quickly," he said. "You don't have to dig a hole." On average, he said they also save between 30% and 50% on construction costs.

According to research firm PKF Hospitality Research, hotel occupancy nationwide through August rose to 63.9% from 58.8% in August 2010. Revenue per available room, a benchmark of profitability, increased to \$70.51 in 2013 from \$57.50 two years earlier. Both figures have largely recovered to prerecession levels.

The improving hotel market also reflects stronger tourism. During New York's 2013 fiscal year, which ended June 30, there were more than 52 million visitors, up 2.1% from 2011, according to a report from the mayor's office. Chicago saw 46.2 million visitors last year, an increase of 6.2% from the year before and just under 2007's record 46.3 million visitors, according to data from the Chicago mayor's office.

Tourism-related spending in the U.S. rose 2.5% last year after a 7.5% jump the year before, according to the U.S. Commerce Department.

To be sure, not all hotel conversion opportunities are being realized. The owners of Chicago Place, a vacant shopping mall located on the Magnificent Mile, a Windy City retail and entertainment corridor, brought in a broker to begin marketing the property as a hotel in recent months, but they still haven't found a buyer. Alex Adjmi, president of A&H Acquisitions, one of the owners of Chicago Place, said the company received strong interest from a big-box tenant but ended up passing on that idea. "We wanted to keep it upscale, and that's the character of the street," he said.

Most hotel conversions involve older offices or warehouses because those buildings have some historic appeal and are often located in prime neighborhoods near business and tourist centers.

"You save probably a year in construction costs, exterior appearance, city zoning and other approvals," said Ted Mandigo, principal at Chicago-based consulting firm TR Mandigo & Co.

Jonathan Jaeger, Pinnacle's New York vice president, said another motivation for conversion projects is the upscale clientele they can draw with the property's historic charm.

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