

LEGAL AND DEVELOPMENT ISSUES OF THE VARIOUS CONDO HOTEL  
STRUCTURES – CASE STUDY: THE ELYSIAN HOTEL & PRIVATE  
RESIDENCES - CHICAGO

by

Mario M. Tricoci, Principal and General Counsel, Elysian Worldwide and Elysian  
Hotel and Resorts

and

Alexandra R. Cole, Chair of the Real Estate and Land Use Practice, Perkins Coie LLP

- I. Condo Hotels – Why are they such an appealing current structure?
  - a. Driven in significant part by the financial interests of developers, hotel owners/operators, the banking community and the purchasing public
    - i. Generally easier to finance a hotel with “for sale” product
    - ii. Earlier return on investments resulting from sale of condo units versus longer term hold of hotel asset
    - iii. Quality hotel amenities can create a premium (avg. 20%) over similar units in traditional condo regime
    - iv.
    - v. Hotel operators can be more selective in determining which assets to which they affiliate themselves as Condo Hotels create a new product type
    - vi. Along with creation of new product type comes creation of new fee arrangements (rental program administrative fees, licensing and branding fees, pre-sale and marketing fees and development consulting fees)
    - vii. Construction lender's risk is generally limited to “sell-out” of condos. Ability to offset traditional hotel financing risk with presale requirements during construction
    - viii. Construction lenders can shift permanent financing or operational risk to the individual unit owners (and/or their lenders)
    - ix. Baby boomer affect: Strong interest in owning for personal (convenience) and financial (potential rental revenue) reasons
  - b. Difficulties, conflicts or risks with Condo Hotels generally
    - i. Complicated legal structure
      1. Condominium structure
        - a. legal regulatory restrictions of a condo association
        - b. manager expectations of individual owners
      2. Rental programs
        - a. Securities issues (register as a security – Reg D filing and compliance, disclosures, etc. not suited for real estate deal)
        - b. Selecting best economic structure for owner/developer mitigate operational expenses
    - ii. Design and construction
      1. Traditional construction risk

2. Conflict between hotel and traditional condo
  - a. Entrance (condo lobby/hotel lobby)
  - b. How much public space
  - c. Size and nature of amenity spaces (spa, restaurant lounge, meeting/business and banquet)
- iii. Marketing and sales
  1. State and federal securities implications in structuring and marketing
  2. Appropriate training and monitoring of sales staff
  3. Sale of real estate not investment/security – cannot promote investment nature of investment
- iv. Operational (hotel operations)
  1. Room inventory management: Must attempt to insure that a sufficient number of condo units will be available as part of hotel inventory. Timing of availability (predictable turnover) is also crucial (e.g., will a sufficient number of condo units be available for convention weekends?)
  2. Comfort that there will be enough hotel business coming from rental of rooms only since owners will not generally be entitled to a share of F&B, spa and retail revenue
  3. Balance hotel operator's need for reliable source of capital necessary for maintenance and repairs in order to carry on the standard required by the hotel operator or brand and developer/owner unwillingness to fund potential shortfalls. In other words, what happens if FFE reserve is insufficient?
  4. Developer/owner must equitably allocate room rental revenue amongst condo unit owners
  5. Developer/owner must be prepared to deal with condo unit owners that are unhappy with income derived from their unit. How to manage condo unit owner's expectations?
- v. Developer issues
  1. Will developer (or owner of residual assets) support hotel operation short falls?
  2. Balancing interests of unit buyer and owner of residual assets (or the hotel)
  3. Will there be an arms length relationship between developer/hotel owner and hotel operator?
  4. What costs (operating, maintenance or otherwise), if any, can developer/owner pass off to unit owners through condo associations?
  5. What unexpected costs, if any, can developer/owner pass off to unit owners through condo associations?
- c. Many different types/structures
  - i. Types
    1. Traditional hotel with condos above – really more equivalent to a mixed use development structure

2. A portion traditional hotel and portion of the rooms sold but subject to a rental program
  3. All rooms sold but subject to a rental program
  - ii. Depends on needs/wants of specific developer/owner
    1. Same structure cannot be employed across the board
    2. Does developer want to retain an interest in the residual assets (i.e., the hotel components)?
    3. Is structure finance driven?
    4. Does developer/owner want to maintain control over common elements to insure consistency in aesthetics and delivery of service?
    5. Who will be in ultimate control of hotel operations?
  - iii. Hotel component branded or not?
    1. Risks of self management versus having a brand
  - iv. Hotel amenities
    1. Condo Hotel unit owners may have access to hotel amenities (spa, housekeeping, room service, etc.) but not all do
    2. How do you fairly allocate costs of these amenities?
    3. How do you assure continued service and consistent with a third party manager?
  - d. Rental Program
    - i. Many different types/structures
    - ii. Components
      1. Income derived from specific unit – no pooling (securities issue)
      2. Revenue share (what percentage to developer/owner and what percentage to condo unit owner?). Does developer/owner take any fees off the top (other than FFE reserve)?
      3. Voluntary versus mandatory
      4. Unrestricted versus partially restricted use of owned unit (e.g., so called blackout dates)
      5. No emphasis on economic or tax benefits
      6. Intrawest “no-action” letter
        - a. Describes limitations on the marketing or promoting of investment nature of condo-hotel to the purchasing public
        - b. Guidelines to no security status
        - c. Prohibits “pooling” of rental income
        - d. Lays out restrictions developers can place on unit owners and their use
      7. Term of rental program
      8. Timing of execution of rental program
- II. Elysian Hotel and Private Residences
- a. General

- i. 60 story ultra luxury condo hotel in Chicago’s prestigious “Gold Coast”
  - ii. Structured to (a) facilitate the creation of new ultra luxury brand and hotel operating entity (Elysian Hotels and Resorts) and (b) five-star hotel asset
  - iii. Close proximity to high-end shopping (Oak Street & Michigan Avenue) and Chicago’s finest restaurants and hotels (Four Seasons, Park Hyatt, Peninsula, The Drake and The Ritz Carlton)
  - iv. The Elysian flagship - first of many (no more than 15 in total) Elysian Hotels and Private Residences to be located throughout U.S., Europe and Asia.
  - v. 180 ultra luxury, five –star all suite (w/balconies) hotel
    - 1. All suites will be sold to unit owners
    - 2. Available to place in rental program
      - a. Rental program likely to be administered by Elysian Hotels & Resorts – also the hotel operator/manager
      - b. Very limited common elements – common elements retained by Elysian
  - vi. 53 private residences (avg. 4000 sq. ft.) – one or two per floor
    - 1. Hotel amenities will be made available
      - a. Some at additional cost per services agreement
  - vii. World class amenities
    - 1. Ground floor lobby and European-styled courtyard
    - 2. Spa and fitness, pool, restaurants, lounge (bar), in-room dining, breakfast restaurant
    - 3. Meeting/conference space, exclusive banquet facilities
    - 4. High-end shopping, on-site parking (valet)
- b. Condo Structure
- i. Vertical subdivision
    - 1. Two residential condominiums
      - a. Very limited common elements
        - i. Developer/owner to control to maintain ultra luxury nature of building and hotel
          - 1. Developer/hotel owner to own and control hallways, entry ways, lobby, building skin, roof, mechanicals, amenity floors and elevators
          - 2. Condo owners (suites and private residences) get access and use privileges vis a vis recordable cross easement agreement
        - ii. Condo associations will have limited control (i.e., to review budgets and pay assessments)
        - iii. Individual owners protected vis a vis condo declarations and cross easement agreement that contain specific requirements on



**Conclusion:**

Decision on structure really driven by the business model of developer. Some are developing Condo Hotels to build a brand and market presence – others using existing brand to enhance sale of condo – these are real estate developers at heart – some using almost purely as financing technique. Legal structures are then modified to enhance success of original developer goals.