

HVS Market Pulse: Rochester, MN – Medicine at the Forefront of Development

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Anchored by the Mayo Clinic, Downtown Rochester has experienced a plethora of development attributed to the \$5.6-billion Destination Medical Center (DMC) initiative, which is the largest economic development initiative in Minnesota’s history.

The healthcare sector is the cornerstone of the Rochester market, represented largely by entities such as the Mayo Clinic, Saint Mary’s Hospital, and Rochester Methodist Hospital, which is visited by over 1.3 million patients per year. After years of expansion and growth, the Downtown Rochester market is expected to receive an even bigger boost with approximately \$5.6 billion of public and private investment injected over the next 20 years through the Destination Medical Center Initiative (DMC). The goal of the initiative is to transform the city into a world-renowned destination medical center. Projects will be aimed at upgrading and expanding the medical, residential, commercial, and infrastructure landscape in Downtown Rochester. The initiative is anticipated to create approximately 30,000 jobs and contribute billions of dollars in tax revenues.

Downtown Rochester’s Key Performance Indicators

	Occupancy	ADR	Size of Market	New Rooms Planned
Downtown Rochester	Low 70s	High \$140s – Low \$150s	2,700+ rooms	1,000
Top Employers	Mayo Clinic IBM Seneca Foods	34,000+ 2,500 600+	Employees (Estimated) (Seasonal & Full-time)	
Unemployment	Declining, now at 1.9%			
Conventions	Renovation and expansion completed in April, 2017; 2018 was a banner year			
Airport	Passenger activity up 36% through September 2018			

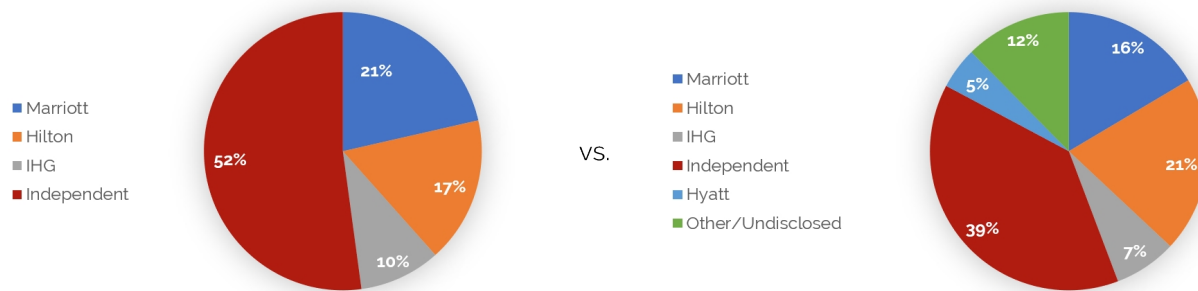
Source: HVS

The DMC plans have been broken into six development sub-districts: Discovery Square, Heart of the City, Downtown Waterfront, St. Mary's Place, Central Station, and UMR & Recreation Area. The largest concentration of development is in the Discovery Square sub-district, which is expected to comprise up to 2,000,000 square feet of new development; this sub-district will be anchored by the Mayo Clinic and will act as the epicenter for the DMC initiative. Discovery Square is anticipated to support collaborative work within the biomedical, research, education, and technology sectors. The first phase of Discovery Square is currently under construction, inclusive of an 81,000-square-foot, mixed-use facility; this project is scheduled for completion in May 2019. Once part of the Downtown Waterfront District, the proposed \$230M mixed-use Bloom Riverfront Project was terminated in February of 2019, which was expected to include condominiums, senior living, retail, and a 180-room four-star hotel.



While a handful of projects relating to the DMC initiative have already been completed, several are currently under construction or in the development phases. A new, 264-room Hilton Hotel is nearing completion along Broadway Avenue, just blocks from the Mayo Clinic, and is expected to open in the second quarter of 2019. The Rochester lodging market is healthy and should continue to remain so, bolstered by significant medical-related demand. Below is a sample representation of the current hotel brand mix in Downtown Rochester, accompanied by the future brand mix based on proposed new hotel supply.

Brand Representation Current vs. Future



Source: STR, HVS

Although a significant portion of the existing hotel supply consists of independent hotels, future supply is anticipated to change the dynamic of the downtown lodging market, allowing travelers access to more branded options to accrue or redeem rewards. As new supply is expected, so are improvements to existing properties in Rochester. It was recently announced that the 660-room Kahler Grand plans to undergo a \$30-million renovation, including the conversion of economy rooms into fewer, larger, contemporary-style rooms; an increase in the number ADA-compliant guestrooms; and the refurbishment of the tower guestrooms.

One of the oldest hotels in Rochester, the Holiday Inn, is currently closed for a major renovation. The hotel, which was built in 1971, benefits from a strong location near the Mayo Clinic and is connected via skyway to the recently renovated and expanded Mayo Civic Center. The hotel was sold for \$18.16 million in March 2018 and closed for renovations in the fall of 2018. Anticipated to reopen in the summer of 2019, the hotel is expected to be converted to the upscale Hotel Indigo brand, featuring an updated layout, modern décor, and refreshed exterior façade.



The entrance of nationally branded new supply and major hotel renovations should put upward pressure on average rates in the market going forward. Thus, yield-management will become a greater issue, as hoteliers will need to determine how to position new and existing assets appropriately. While medical-related and group demand are expected to continue to grow, the outlook is best described as cautiously optimistic given the additions to supply anticipated in the next few years. Continued growth attributed to the DMC initiative is expected to further anchor Downtown Rochester as a world leader for medical advancement and opportunity.

HVS continues to regularly consult in this city from our nearby Minneapolis office. Tanya Pierson is ready to assist you on any consulting needs you may have. Eric Guerrero with HVS Brokerage can also discuss any Rochester asset that you may be considering selling in 2019.