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Market Features

Morgans Hotel in Hard Rock and Hard Place

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Morgans Hotel (MHGC) has lined up a development partner to build a luxury condo project next to its Hard Rock Hotel and Casino in Las Vegas, industry sources say.

If the right deal is announced, it could help spark the stock, which has fallen by a third since the spring and hit a 52-week low of \$11.94 last week.

But building the right project on that land remains a challenge since the high-end Vegas condo market has calmed down from the go-go frenzy of a year ago.

Morgans, a trendy-hotel operator founded by hip-lodging king Ian Schrager, announced in May that it would purchase the popular Hard Rock Casino and the neighboring 23 acres of land for \$770 million.

The large amount of leverage required by the deal spurred worries about the company's liquidity, sending the stock spiraling downward.

Morgans has said it plans to bring in partners to fund two-thirds of the equity before the deal closes in early 2007. The company also plans to either sell or develop the land next to the hotel, which currently houses a low-rent apartment building.

But no announcements have been made, and some have feared that Morgans paid too much for the excess land at a time when the Vegas residential market is slowing.

Bringing Back Buyers

Las Vegas real estate sources say Morgans is planning a luxury condo project very similar to the \$1.2 billion project that Hard Rock founder Peter Morton scrapped before selling the site to Morgans.

"I'm aware of a deal in the works to be developed close to [Morton's] original plans," says David Atwell, a veteran Las Vegas land broker.

Atwell says he is not aware of the precise financial arrangements but says the word is that Morgans will have at least one financial partner in the project and will not be taking on all the risk.

Scott Collins, an investor with Stealth Holdings, a real estate investment firm that funded some of the predevelopment expenses for Morton's luxury condo project (and is now suing Morton and his partners for alleged back money), echoed Atwell.

Collins says several developers, including himself, are interested in a project on the land, but he says he has heard that Morgans has already lined up a deal with an unnamed partner.

Collins also says that the several of the buyers who gave deposits for Morton's condo project remain committed to it. "My understanding is when they offered the money, a majority of buyers said they'd hold and wait," Collins adds.

Morgans didn't return a call seeking comment on the prospective development.

The attorney's office that is handling the disbursements of the deposits declined to comment. "I've been led to believe that a lot of [Morton's] buyers would come back into the deal," says Atwell.

But not all of those buyers want to come back.

Beverly Lacey, owner of real estate firm Vertical Vegas, says she sold 17 units in Morton's original Hard Rock project, including several to investor clients who bought three or four units at time.

All have gotten their deposits back, upon her urging, Lacey says. Instead, she has placed buyers in developments already being built. "I don't think they're going into anything like that [a Hard Rock project] until the structure is built," she says.

A year ago, structures meant nothing. Instead, buzz was what sold projects.

Before Morton scrapped his condo project earlier this year, sales at the development were said to be brisk. Press releases touted that stars Claudia Schiffer, Sergei Fedorov and members of Motley Crue had purchased units in the project, which was planned for completion in 2008.

According to one lawsuit related to the pulled development, Morton purchased the land next to the existing Hard Rock in September 2004 for \$86 million. Morgans says it paid about \$11 million an acre, or \$259 million, for that land.

Bruce Hiatt, broker-owner of Luxury Realty Group, says a number of his clients began pulling out of their interest in Morton's project when the price per square foot starting getting "aggressive for an off-Strip property" at \$1,300 to \$2,000 per square foot.

Several of his clients either canceled their interest or got their deposits back, Hiatt says, and instead bought units at similar prices at the Trump condo hotel project being built across from the **Wynn** (WYNN) casino and the Cosmopolitan condo hotel next to the Bellagio.

Down the road from the Hard Rock, the Edge Group and **Starwood** (HOT) are building the W condo hotel, which is set to open in late 2009.

The project originally planned 500 units for sale. But demand was strong enough after all those units sold to support a second release of an undetermined amount, says Maggie Feldman, a spokeswoman for the project.

Demand Questions

In June, the Edge Group bought the neighboring 25-acre piece of land from Centra Properties and the Related Group, which earlier this year scrapped their Las Ramblas condo project, which was famed for having actor George Clooney as an investor.

The Edge Group's new project may likely include more hotels and condo hotels.

After the Las Ramblas and Peter Morton condo projects were scrapped, some began questioning the viability of the Harmon corridor, the off-Strip area that includes the Hard Rock and W Hotel projects.

The area "will work as long as people understand that its primary operation will be a condo-hotel area," says Hiatt of Luxury Realty Group, rather than luxury condos.

In essence, buyers of high-end luxury condos don't want the buildings to be attached to casinos because they don't like the tourists, whereas condo-hotel owners like the services a casino and hotel offer, he explains.

Morton's plan by the Hard Rock offered a mix of luxury condos and condo hotels. It isn't clear if Morgans is planning a mix.

It's also not clear at what price point Morgans will have to sell condos to make a condo development profitable.

The company paid \$11 million an acre for the land, which many considered a lofty price. If Morgans is planning to offer units at \$1,300 per square foot, around where Morton's planned condos started, it better have something very good to offer, because today's market will not as easily support high prices, brokers agree.

The Signature condos in Tower A at the **MGM** (MGM) Grand are currently reselling for about \$1,000 to \$1,300 per square foot, and they're directly on the Las Vegas Strip.

Meanwhile, depending on whom you believe among Wall Street analysts, Morgans' stock might currently reflect investors' assumptions that the company will be absorbing the entire Hard Rock hotel project upon closing of the sale early next year, with the exception of about \$70 million of intellectual property rights it is expected to sell.

If Morgans announces the condo deal, investors might get some breathing room on liquidity issues.

But with Morgans also planning to build two hotels at the Echelon Place project that **Boyd Gaming** (BYD) plans to construct on the northern part of the Las Vegas Strip, the company has a lot on its plate for a \$407 million market-cap hotelier.

And even if Morgans does grab two-thirds of the equity on the Hard Rock deal from outside investors, the company will still have an 8-times net-debt-to-adjusted-EBITDA ratio at the end of 2007, which is much higher than the below 5-times ratios for comparable public lodging companies, according to a recent report from Merrill Lynch analyst Amanda Bryant, who rates the stock a sell.

When Morgans went public at \$20 in February, the company owned mostly boutique hotels in New York, Miami and Los Angeles. It remains to be seen whether the company can compete with the big boys in Vegas.
