

Building the Bakken Building for Beyond the Boom

WILLISTON: North Dakota is shoveling out from its first major storm of the winter. Not that eight wimpy inches of new snow slows down anything here, however. There are still 30,000 oil wells to drill.

But while the usual frenzied “gett’er done” double time pace continues, western North Dakota now faces a more daunting challenge: building infrastructure that supports a new way of life and culture.

The discovery of the giant Bakken oil and gas field, which the United States Geological Survey describes as the “largest continuous oil accumulation ever assessed by the USGS,” bodes fundamental changes for western North Dakota. People are coming. Lots of people.

Just ask Don Nickell. He is president and chief operating officer of Nakota Development, LLC. The morning Nakota opened their two Value Place extended-stay hotels in Williston in September 2012, “we had people sitting in their cars in the parking lot, waiting for us to open the doors,” said Nickell.

Since then, their Value Place hotels have had an enviable percent occupancy rate (86 percent in October) charging \$699 per week, triple the rate of most Value Place facilities nationwide.

Nickell, who selects Nakota sites and oversees all design and construction, is on a job site as darkness falls over Dickinson, a booming town 130 miles south of Williston. It’s 30 degrees and the temperature is dropping. The site supervisor is wearing four layers of clothing. Nickell wants to be sure – doubly sure, in fact – that the cement work and plumbing for the Dickinson Value Place is being done properly.

“Building in the Bakken is not for the faint of heart,” said Nickell. “We got water and sewer connected just a few weeks before we opened our Williston facilities at the end of last July. We were

supposed to have them by December 2011, but the contractor for the city kept running into issues,” he said.

Nickell is confident more customers are waiting. He’s in good company.

Lynn Helms, director of North Dakota’s Department of Mineral Resources, told an audience at the 2012 North Dakota Association of Oil and Gas Producing Counties that western North Dakota can expect about 250,000 additional people settling west of Highway 83 to help produce oil and natural gas.

Building the infrastructure to build new infrastructure

It’s more than just about oil and gas, however. When Torstein Hole of Statoil ASA recently spoke at the Great Plains and EmPower North Dakota Energy Expo held in Bismarck, he did not spend much time talking about his company’s investments in the Bakken. Statoil, a Norwegian state-owned company, bought Brigham Exploration in 2011 for \$4.4 billion. It owns about 375,000 mineral acres in the Bakken and produces approximately 50,000 barrels of oil per day.

Hole echoed the concern of nearly every speaker at the conference: Can western North Dakota build proper infrastructure fast enough? “It’s clear for me that there will be some challenges during this period of buildout,” Hole told the *Bismarck Tribune*. “I’m sure that we can cope with this in the Bakken. The future for both Williston and North Dakota is bright.”

Housing is of particular concern. The demand is moving beyond man camps and regular hotels. Mike Anderson, director of the North Dakota Housing Finance Agency expects growth to continue in the state for the next 15 to 20 years.

The bar is rising fast. The November announcement that the investment firm Kohlberg Kravis Roberts & Co. (KKR) will build a series of housing developments in Williston signaled the entrance of serious capital into western North Dakota housing.

KKR describes the opportunity to invest in shale gas and oil as “historic,” and that “infrastructure growth is at the heart of this question.”

Appearing on CNBC’s investment program, “Squawk Box,” KKR’s managing director of global real estate, Ralph Rosenberg, said Williston is suffering from a “dramatic undersupply of permanent housing. So we're actually building a neighborhood, 810 multifamily units and 727 single family home lots, a neighborhood with parks and trees.”

Rosenberg is confident that KKR is looking at a 50-year-play in the Bakken. Rosenberg said KKR based its analysis, in part, from figures supplied from Samson Investment Company, a Tulsa-based oil and gas exploration company that KKR purchased for \$7.2 billion in November 2011.

Thus, while thousands of men are living in temporary man camps, a gaping supply hole remains for those seeking housing for two-to-four-month jobs, assignments typical for places like the Bakken. In addition to the thousands of energy company geologists, landmen, environmental technicians, and engineers, who will house the workers building the thousands of new homes and apartments?

Firms like Nakota Development are already two steps ahead in the game; they acquired the Value Place franchise territory rights for North Dakota, Montana, and Wyoming and promptly built two hotels and have a third under construction, a Value Place in Dickinson they expect to open June 2013. Secondly, Nakota has already purchased, or acquired options on, land for additional construction.

Nakota is investing in what it calls “the golden rectangle,” of the Bakken play: 12,000 square miles that encompasses roughly ten counties. The cities of Williston, Dickinson, Minot, and Bismarck represent each corner of the rectangle. Nakota designated these cities as hubs for serving the local infrastructure needs. In addition, Nakota has begun planning for additional Value Place facilities in what Nickell calls “satellite communities” within the golden rectangle, such as Watford City and Tioga.

Nakota also plans to open a Value Place extended stay hotel in Sydney, Montana, by early 2014 and, in addition, build an apartment complex in the newly formed Sand Creek Retail Center that sits on a bluff overlooking Williston and the Missouri River.

The master plan, according to Nakota CEO Art Cahoon, is to invest an estimated \$200 million in the development of twenty new extended stay hotels over the next five years in the Bakken and other shale development areas under their asset holding company, U.S. Shale Lodging Corp.

“Couldn’t Make a Left-Hand Turn.”

Nakota’s experience in North Dakota started when Cahoon traveled to Williston in 2011. Cahoon was a private equity, real estate, and energy investor and was interested in Bakken mineral leases.

What Cahoon – a man with over thirty-five years in the investment business – observed rendered him nearly speechless. “I saw exploding oil and gas development. I saw truck traffic so thick you couldn’t drive through town. You couldn’t make a left-hand turn. Above all, I saw an acute shortage of everything. People were building man camps as fast as they could but it wasn’t nearly fast enough. You’d try to go to lunch and it would take two hours to get served. The city of Williston was completely overwhelmed.”

That night, Cahoon, unable to find a motel room, slept in his truck, his head swirling with ideas.

“I concluded I was too late for investing in oil and gas, the mineral leases were too expensive,” he said. “But Williston was busting with needs, which translates to opportunity.”

The first hurdle Cahoon faced was his own doubt about the duration of the Bakken play. He scoured news stories, government data, financial reports, and oil and gas journals. He took note of the billions of dollars companies like Exxon, Marathon, and Continental Resources, were investing into the Bakken. “It became clear that it would take at least twenty years to complete the initial drilling. Then they’d begin secondary and tertiary oil production,” he said.

The news kept getting better and better. Just a few years ago, the USGS claimed there were three or four billion barrels of recoverable oil in the Bakken. In 2011 the USGS revised this amount to ten billion. The same year Continental Resources, the largest leaseholder in the Bakken, announced it thought the Bakken contained twenty-four billion recoverable barrels of oil.

By contrast, Norway has 5.32 billion barrels of proven oil, the largest oil reserves in Western Europe.

Then came whispers of two additional discoveries: the Three Forks shale formation, located beneath the Bakken, and the sandstone/limestone Tyler formation, located 2,000 feet above the Bakken. The whispers turned to action as companies began extracting an estimated two billion barrels of recoverable oil from the Three Forks. The Tyler has approximately one billion barrels of recoverable oil.

In addition, Cahoon recognized that natural gas would become a major component of Bakken revenues. Hess Energy is spending \$500 million to expand a natural gas processing plant in Tioga. Then ONEOK Partners committed \$350 million to expand their natural gas plant in eastern McKenzie County.

Then came the tough part: financing. “I talked to over 200 banks, directly and indirectly, and couldn’t find one with an acceptable construction loan. But, we so believed in the project, we ended up financing the construction ourselves for our first two hotels until First Interstate Bank of Casper became our lender in mid-2012,” said Cahoon.

Their willingness to invest their own money and complete their first two hotels on schedule bought Nakota a rare commodity: street cred.

“Nakota is very dependable and reliable,” said Tom Rolfstad, executive director of Williston Economic Development. “We’re blessed to have a group like them moving in.”

Rolfstad spoke about Nakota's willingness to recognize economic opportunity, "instead of sitting on the sidelines and worrying about security thus getting a low rate of return. They can see this thing really has life," he said.

Rolfstad said that Nakota also had the good fortune to work with one of the pioneers in developing the Bakken: Granite Peak Development, a Casper, Wyoming-based real estate firm. Nakota bought the site of their Williston Value Place facility from Granite Peak.

"They were among the first companies to take the Bakken development seriously. We in Williston would be way behind if not for Granite Peak," he said.

Finding the right team

Cahoon already had a clear vision when he established Nakota, which he describes as a full-service real estate development and management firm that provides, among its services, "housing to the developing shale-producing regions of the U.S."

The challenge was finding the right team to take on the Bakken. It would take a special combination of investors, engineering, creativity, and management to make things work. Cahoon began with a simple qualifier: "they all had to have grey hair or no hair."

He ended up with a team that was "way, way overqualified to build hotels and manage hotels in North Dakota, but that's exactly what we needed." He cites Nickell as an example. "If there's a problem, any problem, he can solve it."

Nickell, age 59, is not a man unfamiliar with difficult conditions. In fact, he thrives on them. "Every time I finish a project, I want to build the next one a little better, a little faster, and a little more under budget," he said.

Among his accomplishments as senior vice president and chief sector officer for the Haskell Company was building the \$180 million,

82,000-seat Alltel stadium, home of the Jacksonville Jaguars. “We completed that in 18 months,” Nickell said.

He was chief operating officer for the Suitt Construction Company (later acquired by Kellogg Brown & Root), and oversaw numerous significant projects including the building of the 1,400-room Gaylord Palms Hotel and Convention Center in Kissimmee, Florida.

When working on Nakota’s projects in North Dakota, Nickell often arises at 4:00 AM, attends to correspondence, works out, then is off inspecting projects by 7:00.

Why would he take on this job?

“There’s an excitement here, an energy that you don’t find in many places. There are huge rewards here, too, among the highest in the country,” he said.

Flexibility is key for doing business in the Bakken. So is thinking on your feet. “Things change all the time here,” said Doug Walker, who manages operations for Nakota out of an office in Williston. Walker's career includes managing and operating commercial office, retail, and multi-family real estate. Most recently he served as senior vice president with UDR, Inc., a leading public multi-family REIT based in Denver. Walker led the asset quality, condo and retail property groups with budget responsibility over \$60 million annually.

“Doug has taken on tasks one thousand times more complicated than managing hotels in North Dakota,” said Cahoon. “Nakota was really lucky to find him.”

Walker credits his experience in working with complex development projects across the U.S. and thousands of tenants and residents for preparing him for the Williston experience. “Flexibility to make quick decisions and execute with a strong team on the ground is critical to absorb the fast-paced growth of northwest North Dakota,” he said.

More Opportunity Awaits

Despite the significant construction and operating challenges in the Bakken, including the scarcity of materials and high labor costs, Nakota has established itself as the gold standard developer and operator in the Bakken. “Current investors, which include all Nakota’s senior management team, are enjoying huge returns on their investment,” said Cahoon.

While Cahoon declined to give specifics, he confirmed that he expects upcoming Nakota and U.S. Shale Lodging Corp Value Place hotels to command superior rates, often two to three times the national average, and enjoy high occupancy levels. Their low employee count, labor model controls, and operating expenses, he said, assures Nakota of being the low cost provider of new, affordable lodging in each market they enter.

Based on current economics, industry insiders estimate that U.S. Shale Lodging Corp could, at the end of its 4-5 year investment cycle, achieve operating profits of \$40 - \$50 million.