Hotel Valuation and Transaction Trends For the U.S. Lodging Industry

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Current Scenario – The Bad News

The Bad News

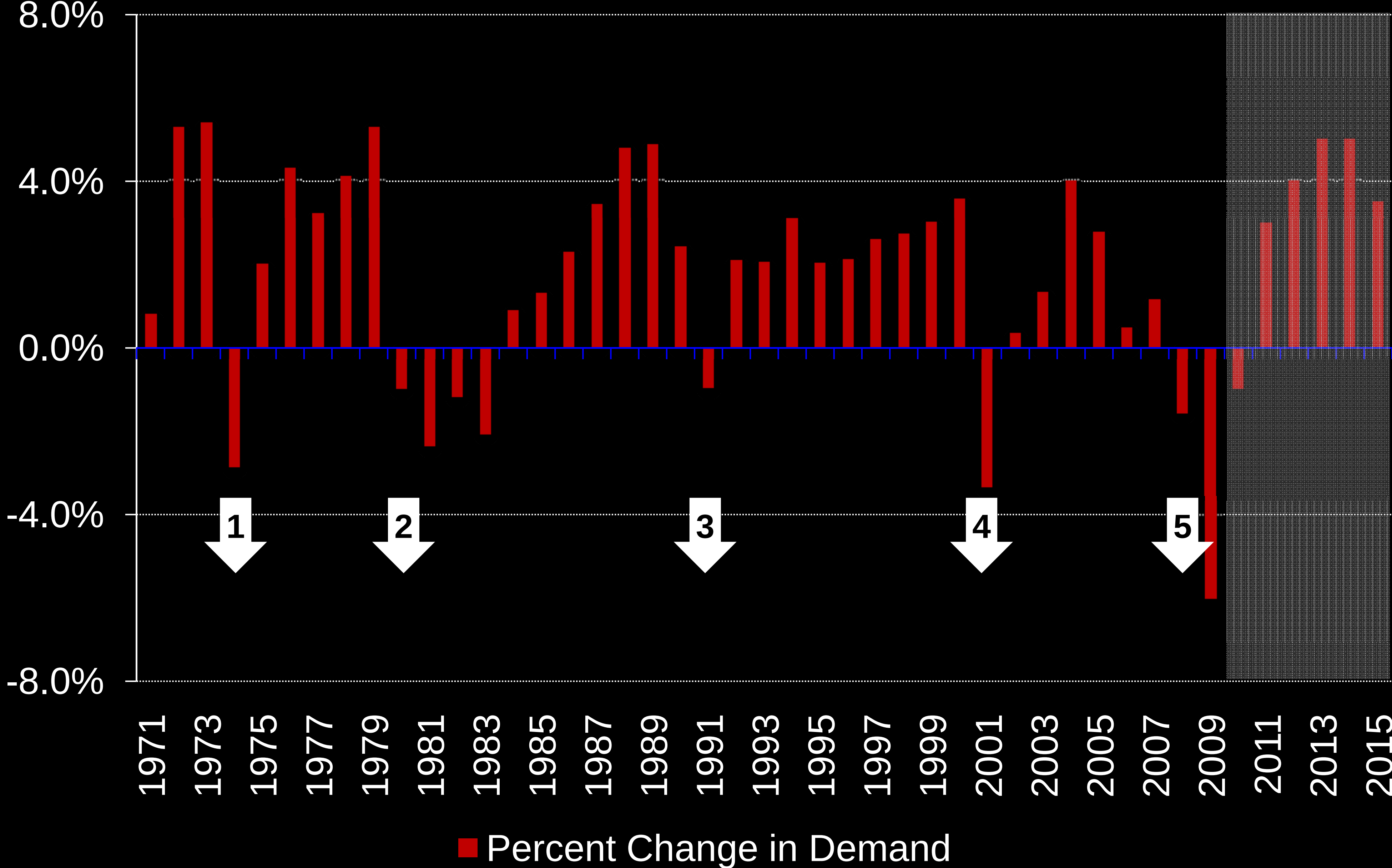
- Severe recession
- Rapidly declining hotel demand
- Falling occupancies
- Declining room rates
- Large loss of RevPAR
- Erosion of hotel values
- Mortgage defaults
- Lack of new financing

Current Scenario – The Good News

<u>The Good News</u>

- Minimal new hotel supply
- Recovery will be rapid and strong
- Huge buying opportunities

The Five Recessions Since 1970 Where Hotel Demand Has Declined



Source: HVS & STR

Economic Crisis: 1980-1982

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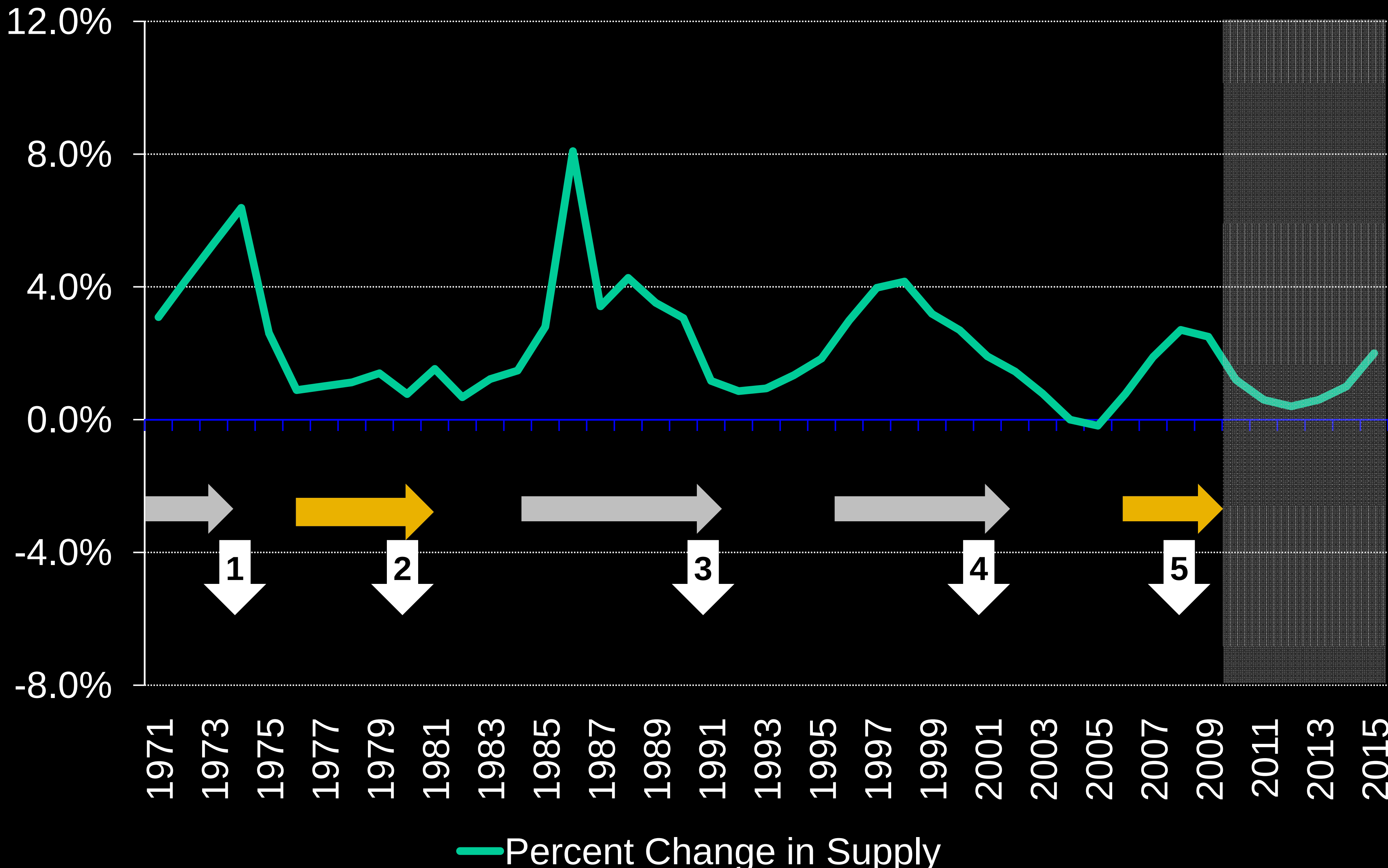
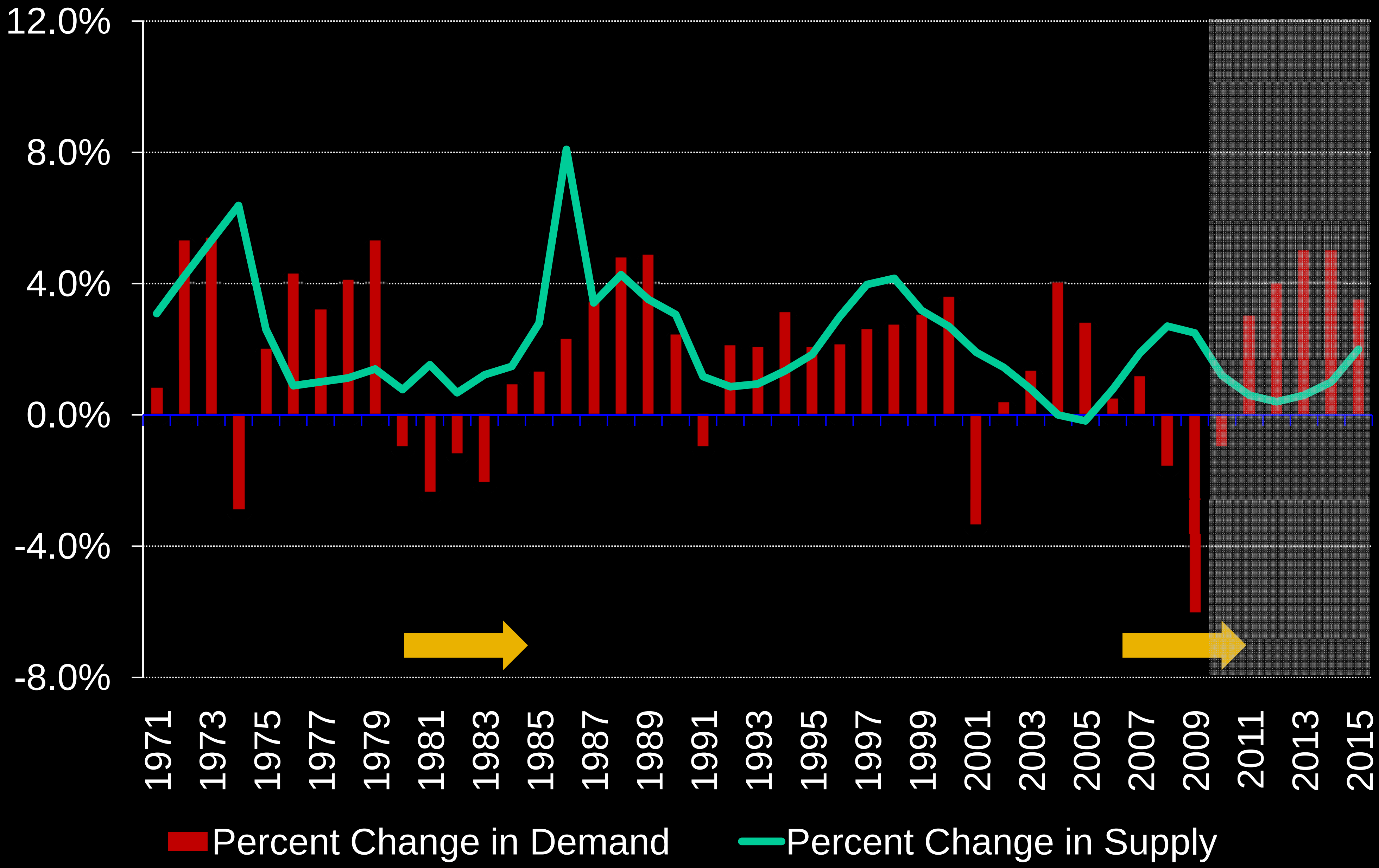
Event:	**1980's Recession**
Dates:	1980 – 1982
Duration:	2 Years
Causes:	• Energy crisis 1979 • Tight monetary policy to control rampant inflation • Long recession • Four years of declining hotel demand
Good News:	• Prior to recession, limited new hotel supply due to high interest rates and availability of financing
Important Note:	• Most similar to current recession • Government stimulus (tax shelters) aided the recovery

Current recession is similar to 1982 slowdown since supply buildup was minimal



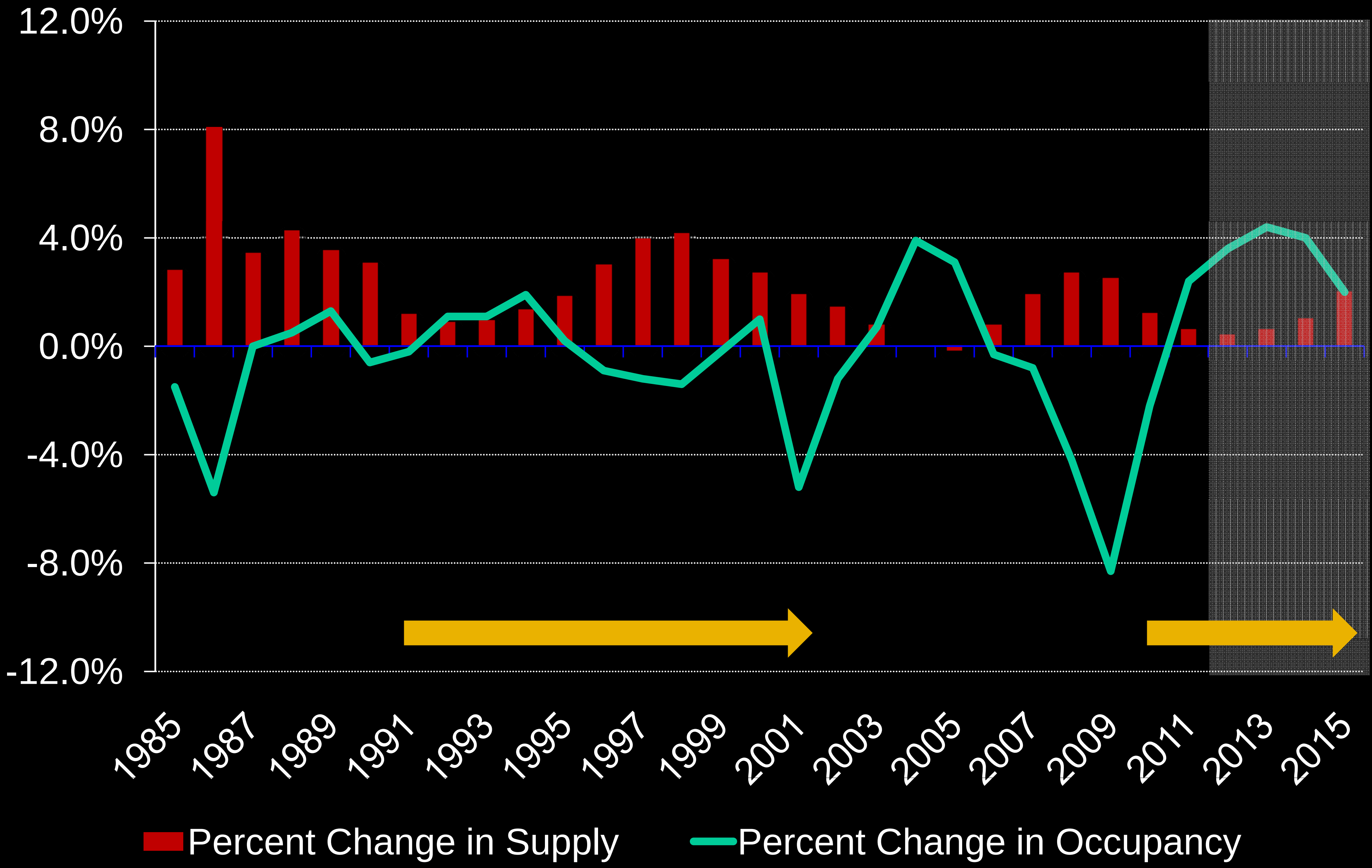
Source: HVS & STR

We anticipate demand recovery will be similar to the recovery after the 1982 recession – 4 Years



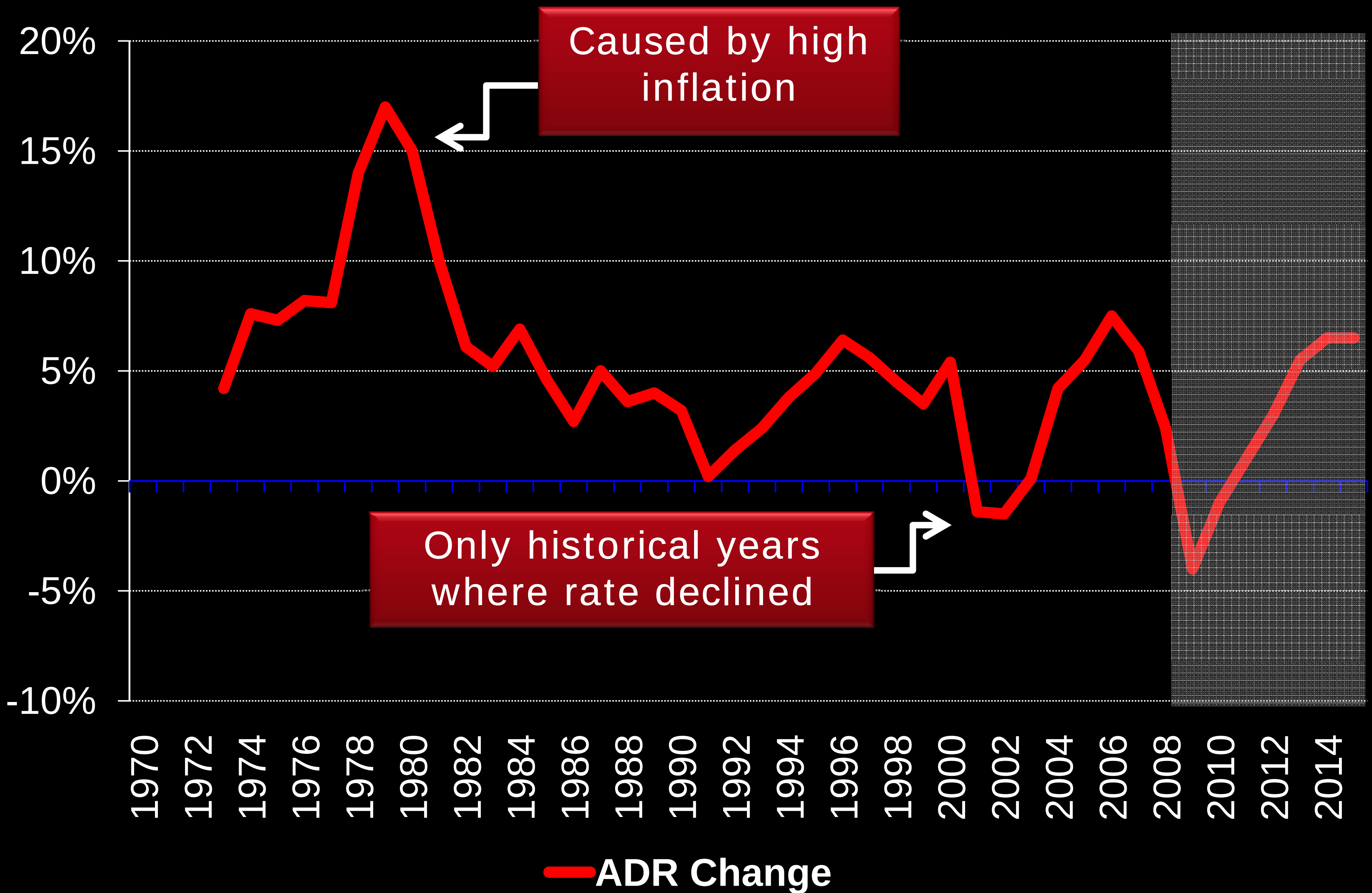
Source: HVS & STR

Occupancy will grow faster than after the 1991 and 2001 recessions



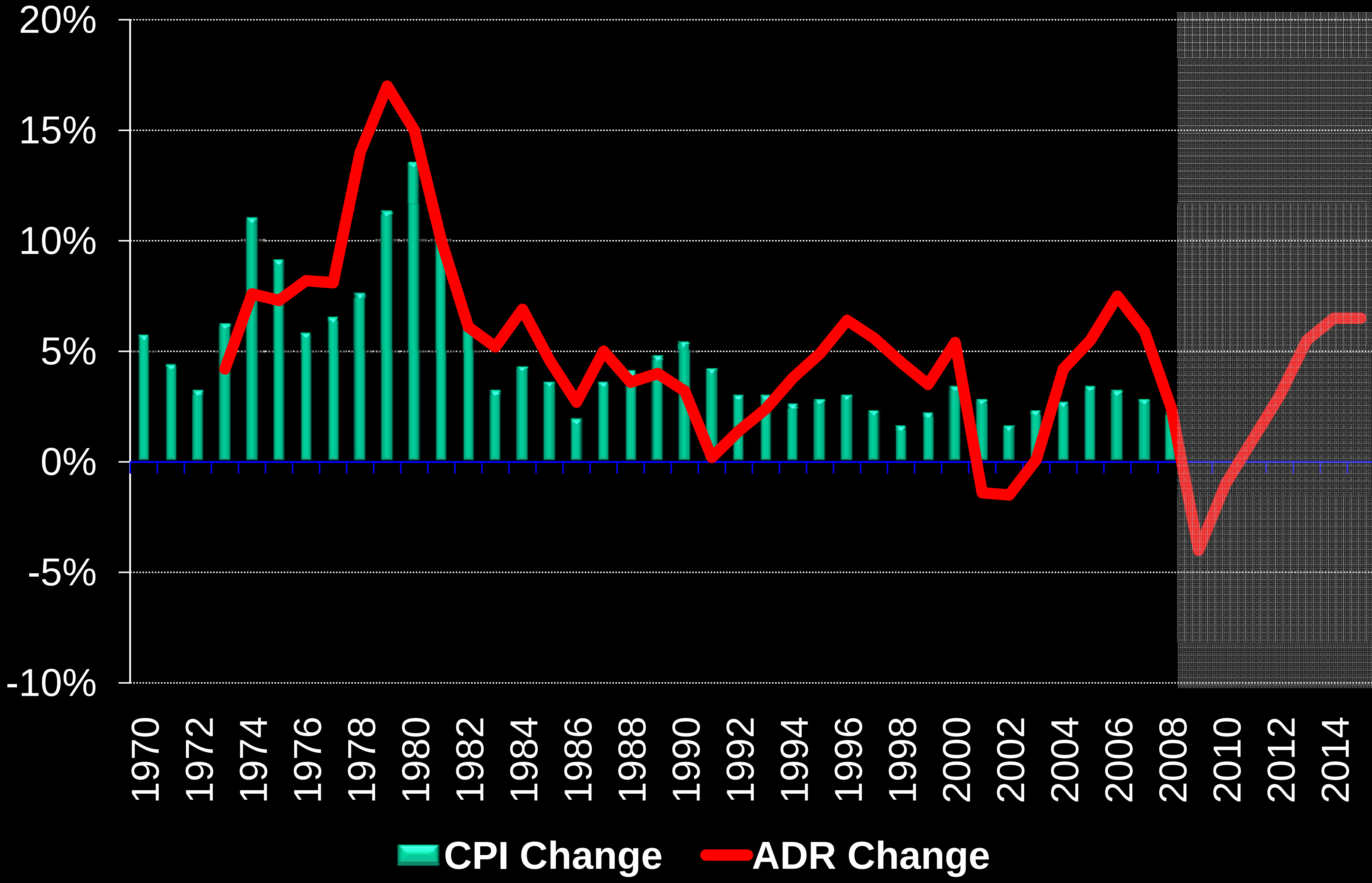
Source: HVS & STR

Hotels prosper during periods of high inflation similar to the late 1970s as ADR keeps pace with inflation



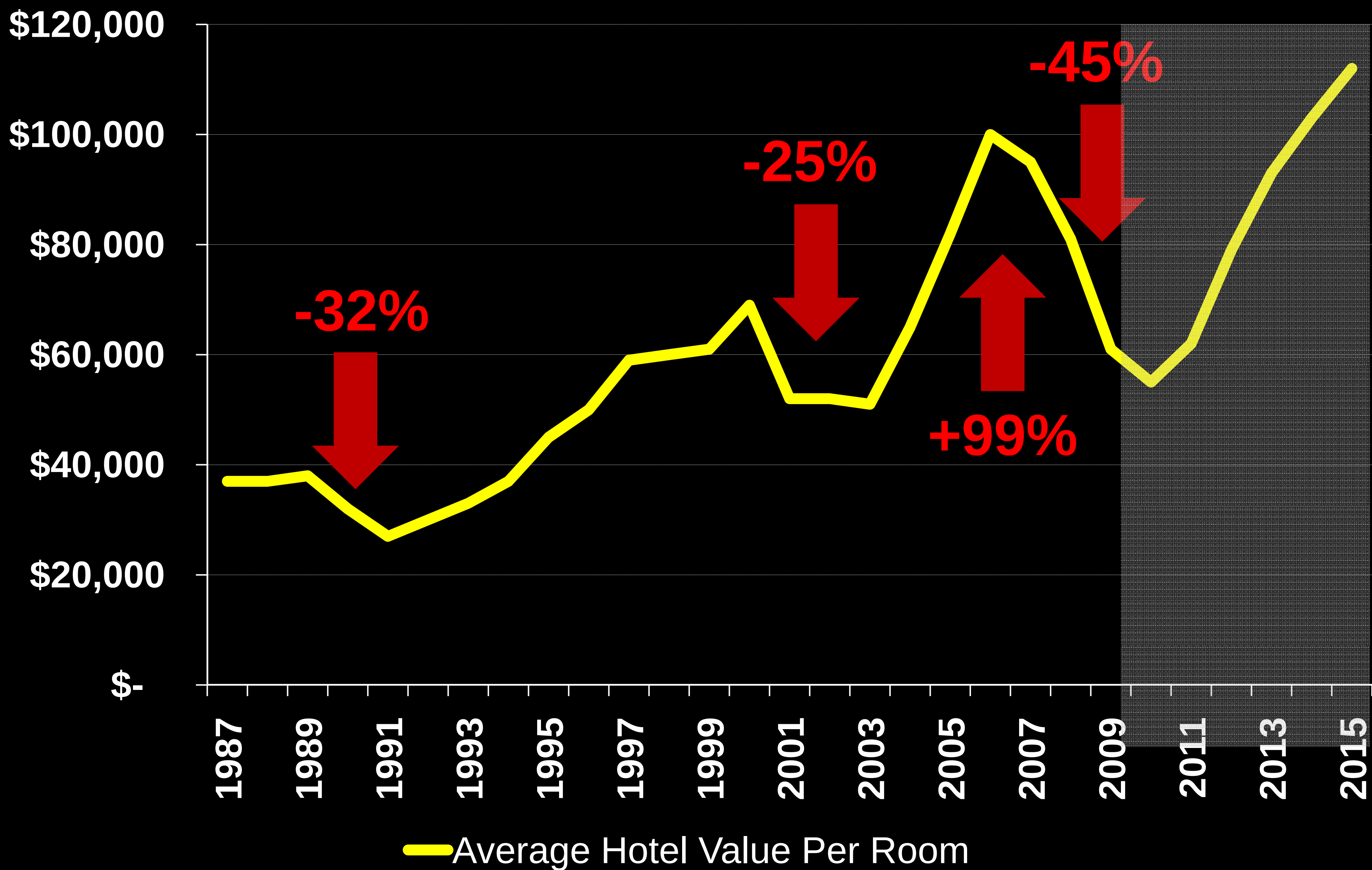
Source: HVS & STR

ADR change usually exceeds CPI change



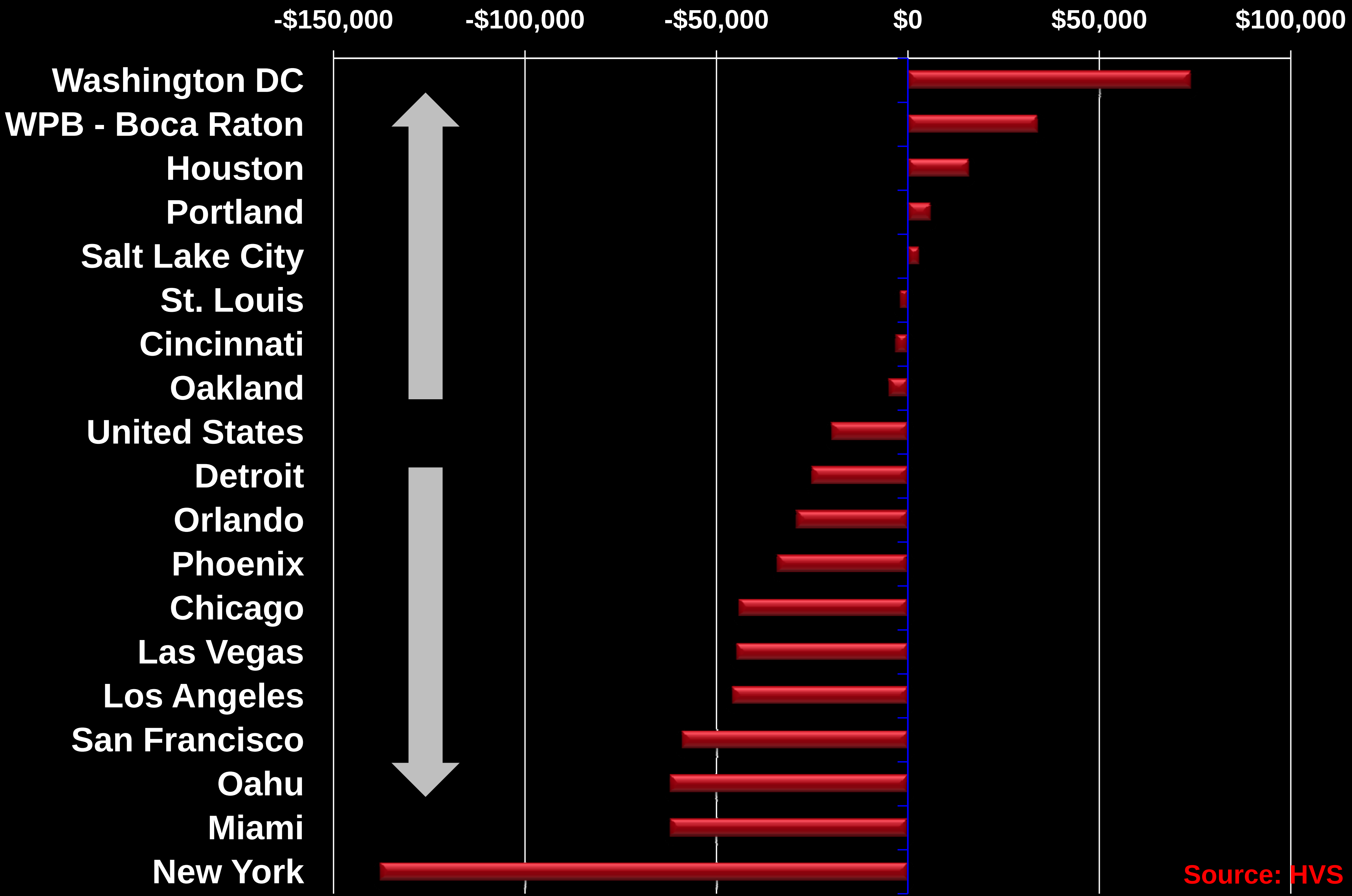
Source: HVS & STR

Hotel values will rebound to peak levels in 2014

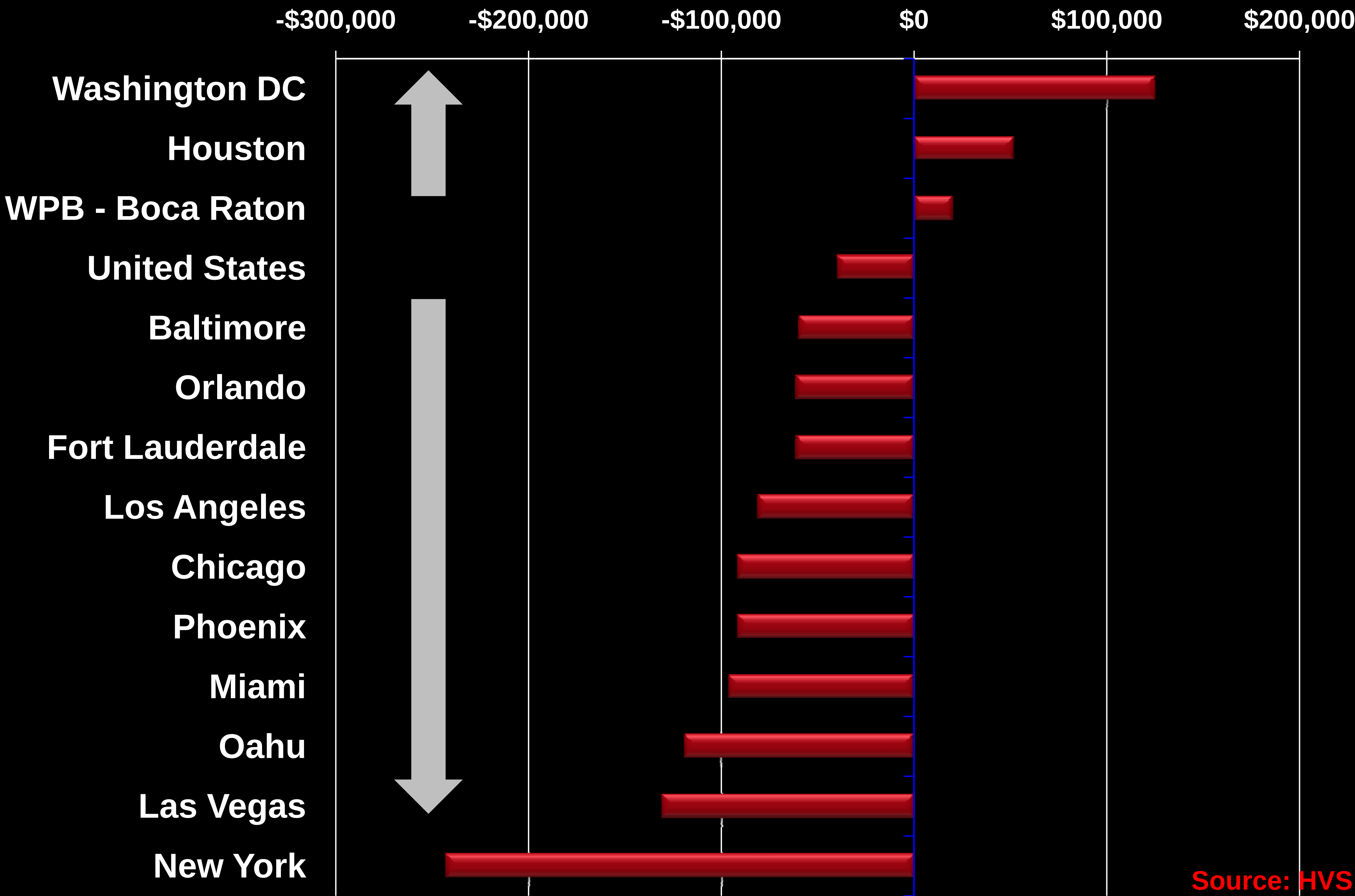


Source: HVS

Estimated Change in Value Per Room: 2009 – The Worst Year

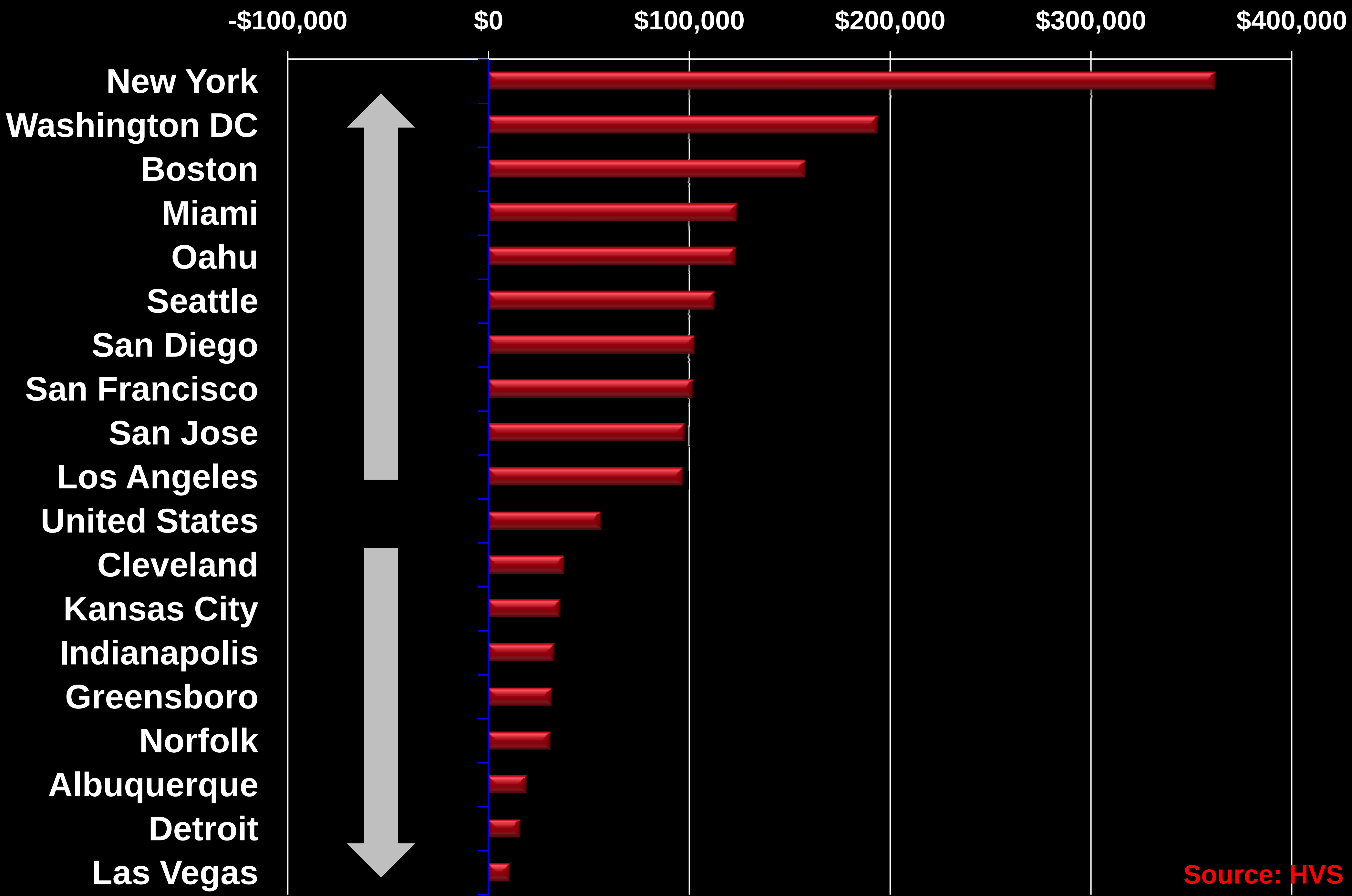


Estimated Change in Value Per Room: 2008 to 2010 – The Worst Period

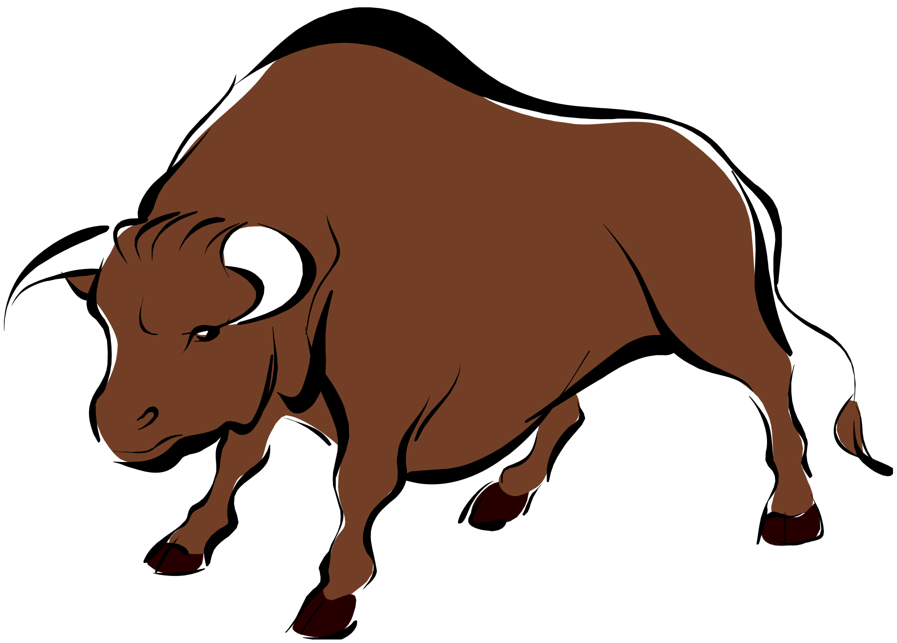


Source: HVS

Estimated Change in Value Per Room: 2010 to 2013 – Recovery



Bullish Markets – Buy!



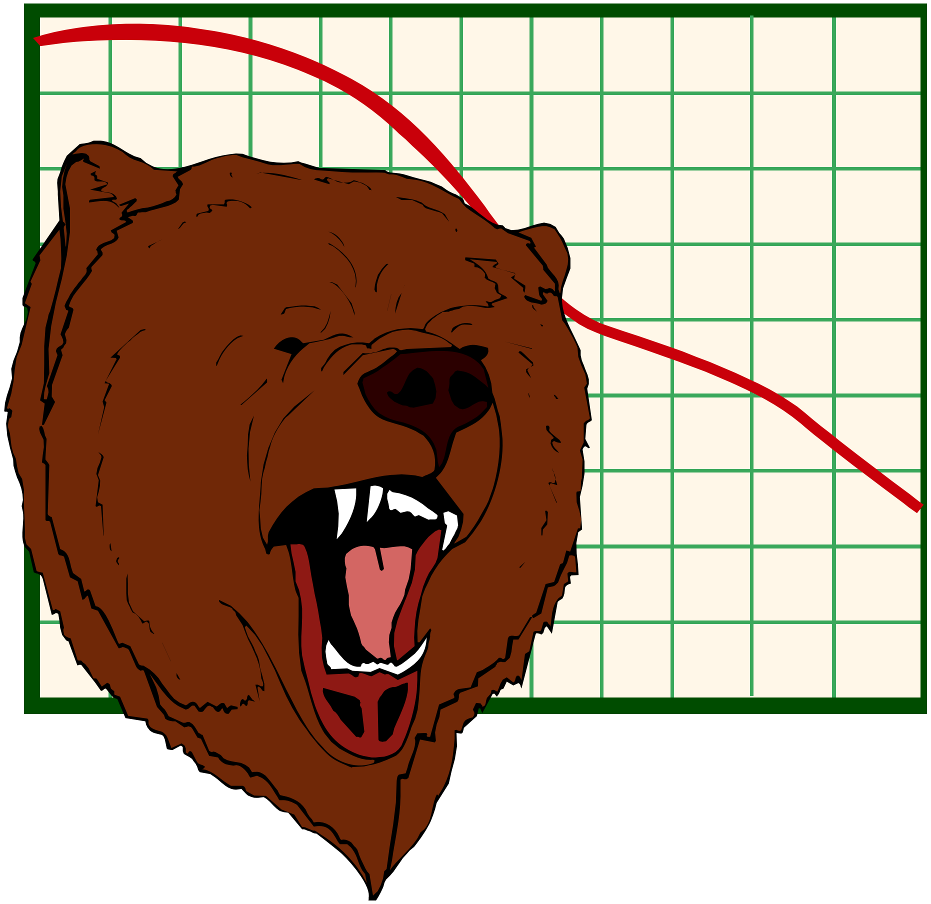
2009

- Washington DC
- Houston

2010

- New York
- Boston
- Miami
- San Diego
- San Francisco

Bearish Markets – Sell!



- Las Vegas
- Detroit

Building Strategy

- Buy existing hotels in 2009 and 2010
- Start building in 2011

Valuation Challenges

- Very few transaction comparables
- Difficult to obtain acquisition financing
  - Low leverage
  - Higher interest rates
  - Lack of debt capital
- Unknown economic recovery timetable
- Market vs. Liquidation value concept

Market vs. Liquidation Value

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Market Value

- Willing Seller
- Neither Buyer nor Seller under pressure to buy or sell
- Sufficient time to expose the hotel to all market participants
  - Current adequate marketing time: 1-2 years

Liquidation Value

- Unwilling Seller – facing foreclosure/bankruptcy
- Seller under extreme pressure to sell
- Limited time to adequately market and sell hotel
  - Inadequate marketing time = less than 1 year
- Discount 20%-50% below market value

Typical Hotel Buyer Methodology

- Normal forecast of Income and Expense based on local supply, demand, rate and occupancy expectations
- Cost of capital (cap rate) based on either low leverage debt or an all-equity financing structure
- Assumed financial recovery where higher leverage debt becomes available at some point in the future

New Valuation Assumptions

Purchase with 50% LTV or all equity

Refinance in 2012 with 70% LTV

Sell in 2018

Valuation per Room using New Valuation Approach

	Year	Net Income Available for Debt Service	Total Annual Debt Service	Plus: Refi/Sales Proceeds	Total Cash Flow to Equity
	2009	$6,675	$3,225		$3,450
	2010	5,556	3,225		2,331
	2011	5,181	3,225		1,956
Refinance	2012	5,728	3,225	$41,104	43,606
	2013	7,210	6,442		768
	2014	9,433	6,442		2,991
	2015	11,593	6,442		5,498
	2016	11,940	6,442		5,856
	2017	12,298	6,442		6,225
Sell	2018	12,667	6,442	60,271	66,496

Valuation per Room using New Valuation Approach

Year	Total Cash Flow to Equity	Present Worth of $1 at 19%	Discounted Cash Flow
2009	$3,450	0.8403	$2,988
2010	2,331	0.7062	1,646
2011	1,956	0.5934	1,161
2012	43,606	0.4987	21,745
2013	768	0.4195	322
2014	2,991	0.3521	1,053
2015	5,498	0.2960	1,524
2016	5,856	0.2487	1,367
2017	6,225	0.2090	1,224
2018	66,496	0.1756	11,676
Value of Equity Component			$44,619
Plus: Value of Initial Mortgage			$36,369
Total Property Value			**$80,998**

Valuation Comparison

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2009 Initial Equity	2012 LTV Refinancing	Value Per Room
50%	75%	$81,000
50%	65%	$79,500
100%	70%	$70,100
100%	65%	$69,500
100%	None	$55,500

Observations & Strategies

- Past recessions show that lowering rate rarely induces demand
- This cycle will adversely impact
  - luxury segment
  - convention and group hotels
  - commercial hotels with negotiated corporate rates
- The unavailability of financing to refinance acquisitions and end of term loans will force a greater number of hotel owners and lenders to quickly dispose of their hotels – thus realizing liquidation not market value

Observations & Strategies

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- In past cycles, lenders who took back hotels and held on to them for values to recover made out far better than those who looked for a quick sale
- If borrowers are honest, maintaining their properties, and paying taxes and insurance, then lenders have little to gain by foreclosing
- If you don’t have to sell – hold on – values will start to recover in 2011

Observations & Strategies

- Don’t let your lender or appraiser value your hotel using liquidation value or 10-year, all-equity assumptions – this was the problem with mark to market accounting valuations
- If you have capital – attempt to buy down your mortgage – look for yields of 15% to 20%
- 2009 and 2010 will be the best hotel buying opportunity since 1991
- If you are a hotel buyer, don’t try to “time the market.” If you find a property that fits your investment criteria, you will get a good deal buying during 2009

Value Trend for a Typical U.S. Hotel

	1987	1988	1989	1990	1991	1992
Value Per Room	$37,000	$37,000	$38,000	$32,000	$27,000	$30,000
Percent Change		0.0%	2.7%	-15.8%	-15.6%	11.1%
Per-Room Change		$0	$1,000	-$6,000	-$5,000	$3,000
	1993	**1994**	**1995**	**1996**	**1997**	**1998**
Value Per Room	$33,000	$37,000	$45,000	$50,000	$59,000	$60,000
Percent Change	10.0%	12.1%	21.6%	11.1%	18.0%	1.7%
Per-Room Change	$3,000	$4,000	$8,000	$5,000	$9,000	$1,000
	1999	**2000**	**2001**	**2002**	**2003**	**2004**
Value Per Room	$61,000	$69,000	$52,000	$52,000	$51,000	$65,000
Percent Change	1.7%	13.1%	-24.6%	0.0%	-1.9%	27.5%
Per-Room Change	$1,000	$8,000	-$17,000	$0	-$1,000	$14,000
	2005	**2006**	**2007**	**2008**	**2009**	**2010**
Value Per Room	$82,000	$100,000	$95,000	$81,000	$61,000	$55,000
Percent Change	26.2%	22.0%	-5.0%	-14.7%	-24.7%	-9.8%
Per-Room Change	$17,000	$18,000	-$5,000	-$14,000	-$20,000	-$6,000
	2011	**2012**	**2013**	**2014**	**2015**	
Value Per Room	$62,000	$79,000	$93,000	$103,000	$112,000	
Percent Change	13.4%	26.1%	18.6%	10.7%	8.6%	
Per-Room Change	$7,000	$16,000	$15,000	$10,000	$9,000	

Source: HVS

Steve Rushmore Biography

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Steve Rushmore is the president and founder of HVS, a global hospitality consulting organization with more than 25 offices around the globe. He directs the worldwide operation of this firm and is responsible for future office expansion and new product development. Steve has provided consultation services for more than 15,000 hotels throughout the world during his 40-year career and specializes in complex issues involving hotel feasibility, valuations, and financing. He was one of the creators of the Microtel concept and was instrumental in its IPO. Steve is a partner in HEI Hospitality, LLC, a hotel investment fund, which makes him one of the few hospitality consultants that actually invest in and own hotels.

As a leading authority and prolific author on the topic of hotel feasibility studies and appraisals, Steve Rushmore has written all five textbooks and two seminars for the Appraisal Institute covering this subject. He has also authored three reference books on hotel investing and has published more than 300 articles. He writes a column for Lodging Hospitality magazine and is widely quoted by major business and professional publications. Steve lectures extensively on hotel trends and has taught hundreds of classes and seminars to more than 20,000 industry professionals.

Steve has a BS degree from the Cornell Hotel School and an MBA from the University of Buffalo. He holds MAI and FRICS appraisal designations and is a CHA (certified hotel administrator). He is a member of numerous hotel industry committees, including IREFAC and the NYU Hotel Investment Conference. In 1999, Steve was recognized by the New York chapter of the Cornell Hotel Society as "Hotelie of the Year."

About HVS

HVS is a global hotel consulting organization with a network of more than 25 offices staffed by over 400 industry professionals spread around the world.

In today's deteriorating economy, HVS has been called upon by leading hotel owners and operators to evaluate their hotel operations. Drawing upon his years of experience through several similar down-cycles, along with experience and data derived from performing thousands of hotel studies, Steve Rushmore and his team have recently focused on assisting hotel owners in understanding their current options. HVS specializes in assisting owners in structuring hotel workout strategies with lenders.

To this end, HVS has the experience necessary to:

- develop individual hotel market studies that assess local supply and demand dynamics
- evaluate the effectiveness of management and brand affiliation
- project income and expense
- determine a hotel's ability to pay debt service during the down-cycle
- predict the timing of the up-cycle and its velocity