

## HOTEL MARKET ANALYSIS

The following analysis is based on information compiled by *The HOST Study 2008 (for the year 2007)*, published by Smith Travel Research and the *Korpacz Real Estate Investor Survey (Third Quarter 2008)*, published by Price Waterhouse Coopers.

### Overview of National Lodging Market

The *HOST Study 2008* (most recent issue available) reported in its review of 2007, “In 2007, the economic slowdown, caused in large part by a sub-prime mortgage crisis that started in August and rising oil costs, began having a negative effect on hotels nationwide. Key lodging indicators began to slow after three years of growth that at times bordered on the unbelievable. And, those indicators were affected as supply began to come online during 2007. However, most of the indicators remained above average in historical terms, which led to the most prosperous year ever in the U.S. lodging industry. The number of guestrooms in the United States grew 1.3 percent during 2007 to a record 4.5 million. Average daily rates jumped 6.0 percent to a record \$103.78, but the growth was slower than it was in 2006. Revenue per available room in 2007 grew 5.7 percent to an all-time high of \$65.52, but again the growth was slower in 2007 than it was in 2006. While occupancy dropped slightly (0.2 percent) to 63.1 percent (the first time since 2002 that it declined), the industry as a whole generated \$106.7 billion in room revenue—a 7.1-percent increase over 2006.” The chart below gives a snapshot look into the overall performance of the lodging industry over the past decade.

**Table 1 | A Decade of Selected Performance Measures**

	SUPPLY % CHG	DEMAND % CHG	OCCUPANCY	% CHG	ADR	% CHG	RevPAR	% CHG	GOP (RTS)	FIXED CHARGES (RTS)
<b>1998</b>	4.0	2.7	63.4	-1.2	78.18	4.5	49.55	3.3	40.2	13.5
<b>1999</b>	3.8	3.0	62.9	-0.8	80.90	3.5	50.87	2.7	39.2	13.9
<b>2000</b>	2.9	3.6	63.3	0.7	85.25	5.4	53.98	6.1	40.9	13.5
<b>2001</b>	2.4	-3.4	59.8	-5.6	84.02	-1.4	50.22	-7.0	37.1	17.7
<b>2002</b>	1.6	0.3	59.0	-1.2	82.78	-1.5	48.88	-2.7	35.7	18.2
<b>2003</b>	1.0	1.3	59.2	0.3	82.90	0.2	49.11	0.5	35.0	18.9
<b>2004</b>	0.4	4.0	61.4	3.6	86.35	4.2	52.98	7.9	36.6	18.0
<b>2005</b>	-0.1	2.8	63.1	2.9	91.10	5.5	57.50	8.5	38.8	16.2
<b>2006</b>	0.2	0.5	63.3	0.3	97.92	7.5	61.97	7.8	41.3	17.2
<b>2007</b>	1.3	1.1	63.1	-0.2	103.78	6.0	65.52	5.7	41.3	16.8

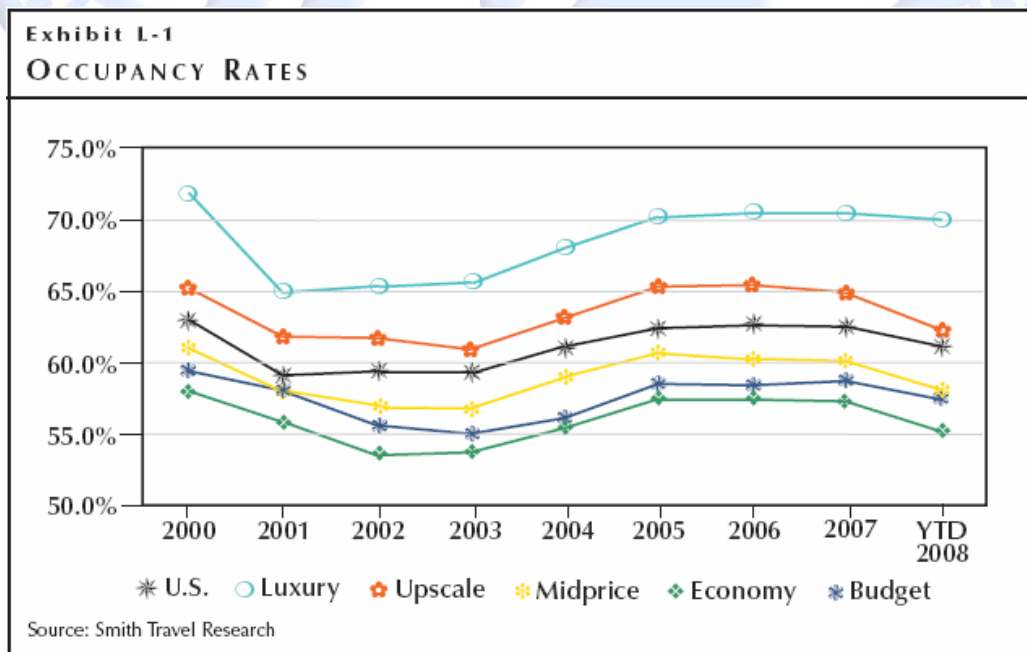
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## Development

Though the volume of room starts has begun to slow, the pace through the second quarter of 2008 remained relatively strong. Even as PwC (Price Waterhouse Coopers) anticipates the pace of room starts to decelerate in the second half of 2008, projects under construction are expected to reach completion and result in 2008 end of year supply growth of 2.1%, the fastest annual growth since 2000. In 2007, average room supply grew the most in the upscale and mid scale without food and beverage (F&B) lodging segments, which each posted a year over year increase of 4.1%. The luxury segment trailed them with a 3.0% average increase in room supply, while the upper-upscale segment reported a growth rate of 1.5%. Only the mid scale with F&B segment experienced a decrease in room supply in 2007, declining by 2.6%.

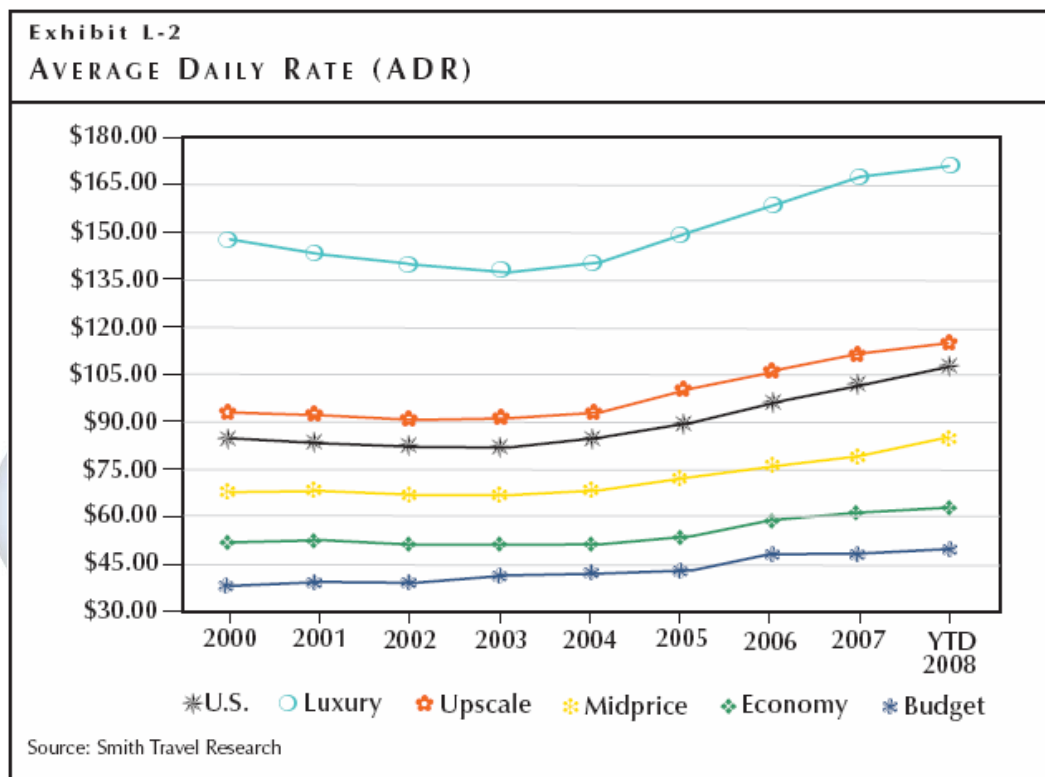
## Occupancy

The Korpacz report stated that “Overall occupancy for the lodging industry was 61.4% for the first half of 2008, a 2.6% decrease from the same period in 2007, according to STR (see Exhibit L-1). Occupancy levels declined in each chain-scale segment over this time period with the mid scale-with-F&B posting the large loss of 4.1%. The upper-upscale chain scale segment posted the smallest shift in occupancy between year-to-date 2007 and year-to-date 2008, moving down 1.7%.”



## Average Daily Rate (ADR)

The Korpacz report stated that “The overall ADR for the lodging industry was \$107.64 for the first half of 2008, a 4.2% increase from the same period in 2007, according to STR (see Exhibit L-2). Improvement in ADR was reported in all chain scale segments over the past year. The mid price-without-F&B segment posted the highest annual ADR increase at 4.6% with mid scale-with-F&B close behind at 4.2%. The economy chain-scale segment posted the lowest gain at 2.0%.”



## National Economy/Limited-Service Lodging Segment

The Korpacz survey from the Third Quarter 2008 reported, “On one side, the midscale-without-food-and-beverage (F&B) segment remains one of the top-performing chain scales within the lodging industry, posting solid gains in both ADR and RevPAR growth during the first six months of 2008 compared with the same period in 2007. Specifically, ADR grew by 4.6% in the midscale-without-F&B segment during that time frame, while RevPAR grew by 6.5%, according to Smith Travel Research. In sharp contrast, the economy chain scale's performance continued to lag, recording ADR growth of 2.0% and a RevPAR loss of 1.8% during that time period.”

According to the August 2008 edition of *PricewaterhouseCoopers Hospitality Directions - U.S. Edition*, occupancy in the economy segment continues to post quarter-over-quarter declines on a seasonally adjusted basis. When combined with additions to supply and limited increases in ADR, this segment is expected to experience a 2.6% decrease in RevPAR for 2008 (see Table EL-1). On the other hand, strong gains in ADR and positive demand trends will allow the midscale-without-F&B segment to hold RevPAR quite steady in 2008 and then experience an increase in 2009.

A weak economic climate, lingering uncertainty about the near-term performance of this lodging segment, and tighter debt markets have stalled the acquisition pace of many investors. As a result, the number of trades involving limited-service assets has fallen considerably over the past year. In the 12 months ending June 2008, a total of 566 limited-service assets sold, according to Real Capital Analytics, Inc. This figure is down 60.0% from the same period last year. The average sale price for these assets was down 3.0% for that time period.”

	CURRENT QUARTER	FIRST QUARTER 2008	YEAR AGO
<b>DISCOUNT RATE (IRR)<sup>a</sup></b>			
Range	10.00% – 18.00%	10.00% – 18.00%	10.00% – 18.00%
Average	12.35%	12.35%	12.35%
Change (Basis Points)		0	0
<b>OVERALL CAP RATE (OAR)<sup>a</sup></b>			
Range	6.50% – 14.00%	6.50% – 14.00%	6.50% – 14.00%
Average	9.83%	9.58%	9.58%
Change (Basis Points)		+ 25	+ 25
<b>RESIDUAL CAP RATE</b>			
Range	7.00% – 14.00%	7.00% – 14.00%	7.00% – 14.00%
Average	10.29%	10.04%	10.04%
Change (Basis Points)		+ 25	+ 25
<b>AVERAGE DAILY RATE CHG. RATE<sup>b</sup></b>			
Range	(4.00%) – 9.00%	1.00% – 9.00%	1.00% – 9.00%
Average	2.83%	4.08%	4.00%
Change (Basis Points)		- 125	- 117
<b>OPERATING EXPENSE CHG. RATE<sup>b</sup></b>			
Range	2.00% – 4.00%	2.00% – 4.00%	2.00% – 4.00%
Average	3.10%	3.10%	3.10%
Change (Basis Points)		0	0
<b>AVERAGE MARKETING TIME<sup>c</sup></b>			
Range	3.00 – 10.00	3.00 – 10.00	3.00 – 10.00
Average	6.40	6.40	6.40
Change (%)		0	0
a. Rate on unleveraged, all-cash transactions    b. Initial rate of change    c. In months			

The table below details the industry's outlook for the economy/limited-service lodging segment (source: Korpacz survey, 3<sup>rd</sup> Quarter 2008).

	<u>2008</u>	<u>2009</u>
<b>Midprice without F&amp;B</b>		
Occupancy	63.2%	62.1%
ADR	\$90.73	\$94.25
RevPAR Growth	+ 0.6%	+ 2.1%
<b>Economy</b>		
Occupancy	54.6%	53.9%
ADR	\$54.70	\$55.72
RevPAR Growth	- 2.6%	+ 0.6%
Source: <i>Hospitality Directions – U.S. Editions</i> , published by PricewaterhouseCoopers LLP; August 2008		

### **Outlook for 2008 and Beyond**

Smith Travel Research concludes the 2008 Host Report with their future outlook, as follows. “Clearly the economic environment will impact hotels during 2008. The sub-prime mortgage crisis and rising oil prices will leave their marks on an industry that had only recently completely recovered from the 2001 downturn and 9/11. However, we believe hotel operators learned their lesson after 2001 and will not resort to drastic price discounts that they applied in the past. Pricing power is here to stay, and we expect it to remain around the rate of inflation.

On the heels of 2007's 6.0-percent ADR increase, we project that the national ADR will grow 4.4 percent in 2008 and 4 percent in 2009—both above the 20-year average of 3.5 percent. Despite the uncertain global economy, we expect the domestic hotel room supply to grow 2.4 percent in 2008 and 2.4 percent in 2009—above the 20-year average of 1.9 percent. In turn, we project demand growth during the next two years to be below the 20-year average of 1.8 percent—1.0 percent in 2008 and 1.3 percent in 2009. The drop in demand will result in a declining national occupancy rate. We project that both 2008 and 2009 will see the lowest occupancy rates since 2004—62.3 percent in 2008 and 61.6 percent in 2009. Those declines are -1.4 percent and -1.1 percent, respectively, and fall well below the 20-year average of -0.1 percent. All of this indicates an increase in RevPAR during the next two years, although we don't expect it to reach the 20-year average of 3.4 percent. RevPAR will grow 3 percent in 2008 and 2.8 percent in 2009. A slowing economy will create slower demand growth, although the weak U.S. dollar is boosting the U.S. as a travel destination for global travelers.”

PKF Hospitality Research is forecasting a continued deterioration in hotel performance in 2009 after a very slow 2008. Based on its October 8, 2008 special Hotel Horizons<sup>SM</sup> report, PKF-HR is projecting 2008 year-end occupancy to be 3.3 percent lower than 2007 levels. Concurrently, the forecast calls for a 3.2 percent increase in ADR for 2008.

Based on Moody's Economy.com September 2008 forecast, PKF-HR is projecting a 4.4 percent decline in hotel occupancy for 2009, along with a slight 0.1 percent gain in ADR. This should translate into a 4.6 percent decrease in total revenue, and ultimately a 7.9 percent knock to the bottom line, for the average U.S. hotel.

### **Local Market**

Locally, the Tampa Bay area is very dependent on the tourist industry. A large number of hotels have been added to this market over the past few years. Yet, some markets have experienced changes more rapidly than others. The airport market has experienced several new hotels with many planned. You recently read in the Tampa Bay Business Journal where the developer of TripPointe Plaza, a \$65 million mixed use development going up in Westshore on Boy Scout Road and Manhattan filed a \$1.97 million lien on the Las Vegas company developing the 12-story Westin Element Hotel, the largest component of the project. I also understand that the Ritz Carlton planned for Rocky Point has been either put on hold or cancelled.

A significant trend at the beach has been the loss of hotel/motel rooms. While it may have been perceived as an improvement razing these old 50's vintage structures for new condo development, it has caused a reduction in tourism that adversely affected supporting businesses. Now that the condo market has plummeted, the once perceived eyesores may have new appeal. In my opinion, there is a need to convert many of them to boutique motels that service a niche of tourists who will return year after year staying for weeks at a time at an affordable rate.

My overall opinion is that the economy is going to have a significant adverse affect on this industry. When we appraise a hotel, we estimate the ADR, average daily rate and that is multiplied by the stabilized occupancy rate to indicate gross revenue. The amount can vary significantly with slight changes in rents or occupancy. The costs of good sold, departmental costs, and fixed expenses are deducted to indicate net income which is the income from the going concerns. In the past, net income was capitalized between 10% and 14% or about 2% to 4% above other commercial properties because net income can fluctuate so much. However, in the past few years cap rates were driven down to 8% to 11% which means that when net income goes down, values decrease even more dramatically. I think we are going to see the market move toward historical cap rates which will severely impact hotel prices in the near future.