

THE LODGING LEDGER

SPRING 2009

BY



SOMBER INVESTMENT MOOD IN 1ST QTR

As expected, there has been a dearth of transaction activity in the first quarter of 2009. The grim atmosphere at ALIS this year was telling. While there may be some attractive assets on the market, the dismal outlook for the lodging industry and the lack of available debt for commercial real estate has severely limited deal activity since the latter half of 2008.

Over the past few years, hotel properties often traded at exorbitant prices driven by residential economics in the form of conversions or expansions. However, the collapse of the residential market, coupled with the fall of the condo-hotel fad, has resulted in numerous properties defaulting on their loans due to their inability to successfully sell units. The Ilikai in Honolulu, the Royal Palm in Miami Beach, and the former W Honolulu are just a few of the planned condo conversions that are in various stages of the foreclosure process.

Opening a hotel/residential property in the current environment is obviously not what developers had envisioned when they initiated their projects a few years ago. The Vail Plaza Hotel & Club, located in the heart of

Vail Village, opened in late 2007 and filed for bankruptcy less than a year later. The W Scottsdale, which debuted last September, is already in foreclosure. The Montelucia InterContinental opened in November and quickly found itself in the same situation. Both Scottsdale properties are set for the auction block in April.

For some struggling properties, the current financial crisis pushed them over the edge, finally resulting in foreclosure. The Renaissance Grand & Suites in St. Louis, which has failed to meet expectations since opening in 2002, was foreclosed upon in January by bondholders. The bondholders acquired full ownership at an auction in February for \$98 million (\$90,000 per key).

The effects of the economic downturn are not limited to newer hotels either. Since this year began, Daufuskie Island Resort and the legendary Greenbrier Resort each filed for bankruptcy, and the landmark Vernon Manor in Cincinnati closed for business.

A couple of large transactions managed to close in the first quarter. Most notably, Host Hotels & Resorts sold

the Hyatt Regency Boston Financial District for \$130 million (\$260,000 per room). Still, less than \$250 million in upscale and luxury lodging assets traded during each of the past two quarters, marking the least active periods since the third quarter of 2002 when less than \$180 million in hotel assets changed hands.

It remains to be seen how effective the government's toxic asset plan will be on loosening the stagnant debt markets. The hope is that by the latter half of 2009, the lending environment will show some movement and high-end commercial real estate transactions will become more feasible, albeit at more conservative terms than we have seen in recent years.

However, if debt remains elusive for the remainder of the year, investors will continue to struggle to refinance maturing loans and fund new acquisitions. Extending and/or reworking the terms of existing loans may become the primary method for some properties or companies to remain solvent.

UPSCALE & LUXURY LODGING DEAL VOLUME

	Deal Volume
Q2 2007	\$6,500,000,000
Q3 2007	2,600,000,000
Q4 2007	3,500,000,000
Q1 2008	1,700,000,000
Q2 2008	1,300,000,000
Q3 2008	1,200,000,000
Q4 2008	180,000,000
Q1 2009	230,000,000

SOURCE: HOSPITIUM



The Renaissance Grand & Suites in St. Louis, a \$300 million publicly-financed project that opened in 2002, was sold to bondholders for \$98 million.

PHOTO COURTESY:
MARRIOTT INTERNATIONAL

IN THIS ISSUE

Transactions Update

Loss in Value

NYC Select-Service
Hotels Draw Investors

Economic Conditions
Impact New Projects

2008 Performance

2009 Projections



WHERE'D MY VALUE GO?

If a tree falls in the forest and no one is around to hear it, does it make a sound? We may never know the answer to this philosophical question. By the same token, how can we determine the true market value of a real estate asset if transaction activity is at a standstill?

The various definitions of market value assumes the existence of a competitive market; that price is unaffected by undue stimuli; and buyer and seller are typically motivated and not under duress.

These characteristics do not appear to exist in the our stagnant marketplace. The market is not very competitive and there is a plethora of undue stimuli. The lack of available debt, economic uncertainty, record RevPAR declines, and a poor lodging outlook are just a few of the factors affecting prices. Donald Trump referred to the global economic crisis as "a once-in-a-lifetime credit tsunami." And anyone selling today is probably under some level of duress (or else they would probably not be selling).

So what is market value when there is no market? This is a large part of the debate over the mark-to-market accounting rule that has impacted the asset values at financial institutions. Since many of their assets have no potential buyers at the current time, they have

been marked down to virtually nothing. Many banks argue that writing down assets to distressed market values does not make sense since they would not intend to sell assets in a bad market.

Nevertheless, most people tend to look at what something is worth today on the open market when discussing value, regardless of whether there is any intent to sell. We have all heard people discuss how their IRAs lost tens or even hundreds of thousands of dollars over the past year. Never mind the fact that they will not actually be withdrawing from their IRAs for another decade or three!

Despite the lack of transaction activity, using various assumptions, many lodging analysts have estimated that market values have declined 30% to 50% in the past year. This is quite possibly true given the decline in NOIs, stricter debt terms (assuming financing can be obtained), and higher risk.

It is important to note that market value is not just a snapshot in time, it should reflect the long-term viability of an investment. One of the basic principles of valuation is anticipation, which is the expected future benefits one can expect from an investment. Those with a draconian view of the market might argue that a property with no cash flow or negative cash flow is worth nothing

today. However, one must look at the bigger picture when reviewing the impact of the economic crisis on asset values.

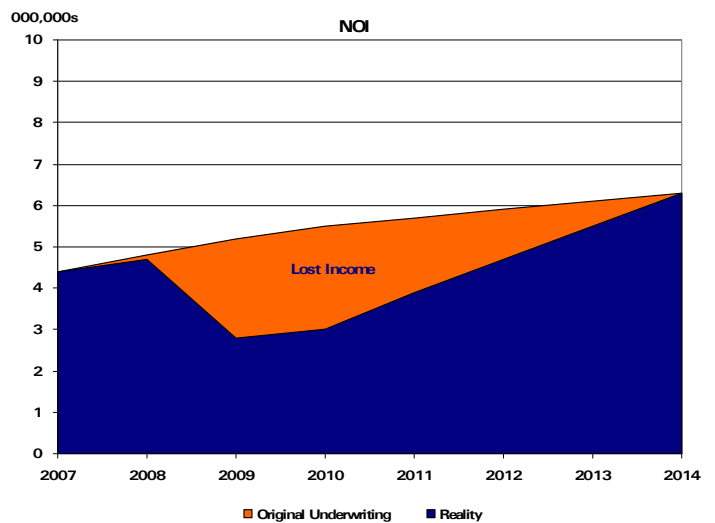
Yes, revenues are down considerably, but it is unrealistic to assume that this is a permanent detour on an asset's cash flow potential. In 2002 as part of the "new normal," many people insinuated that we had fallen off the prior growth curve and would never return to the same levels. Well, a couple of years of double-digit RevPAR growth quickly altered that mentality when the industry rebounded.

So, while a return to the historical cash flow levels is theoretically supportable, there may be a fundamental shift in debt terms. While this cannot be readily proven with current data, or lack thereof, it is almost a foregone conclusion as the debt markets have been the catalyst for much of the current

crisis. Furthermore, equity yield expectations are much higher in down markets as the risk level for buyers is much greater. Where equity return levels averaged between 15% and 18% at the height of the market, they are certainly above 20% today.

Looking at a typical 250-room upscale hotel acquisition underwritten in 2006 and then comparing it to the new reality and how one might expect cash flows to recover, one can better grasp the loss of income. This analysis shows a 40% decline in NOI in 2009, a slight up tick in 2010, and a strong recover thereafter with the asset returning to its original NOI projections by the end of the hold period (five years from now).

The impact of the lost income from the original underwriting to the reality of today is fairly significant, yet how this affects an invest-





WHERE'D MY VALUE GO? (CONT.)

ment is somewhat difficult to ascertain given all the assumptions necessary to value the property with very few current benchmarks to analyze. There are several ways to look at it depending on whether the owner is holding or selling. In each scenario, we assumed the exit cap rate of 9.0% in 2014 would still be relevant.

By continuing to hold the asset, the IRR over the investment period drops from 18.3% to 13.2%. A 13.2% return may not be too difficult to swallow given the current environment.

Revaluing it today with the debt in place and the required IRR of 18.3%, the asset would be worth \$56.6 million, \$3.4 million less than the acquisition price. Keep in mind this is considered investment value, not

market value. Nevertheless, this value is probably most relevant to an owner in a position to hold the asset. However, based on the diminished NOI expected in 2009 and 2010, the property's cash flow will be unable to cover debt service. Thus, the owner will be required to infuse the deal with capital in order to avoid default.

Unless the loan is assumable, a potential buyer would have a much different return analysis for the asset, and consequently any offer would fall far below an owner's investment value. Looking at the asset from a buyer's perspective changes the financing and most likely the return requirements. Again, for the sake of comparison, we assumed the exit cap rate of 9.0% is still justified.

	Original		Sell	
	Underwriting	Hold	Finance Now	Finance Later
Value	\$60 million	\$56.6 million	\$47 million	\$38.9 million
Cap Rate on TTM	6.5%	8.3%	10.0%	12.0%
Going-In Cap Rate	7.3%	4.9%	6.0%	7.2%
Exit Price	\$70 million	\$70 million	\$76 million	\$76 million
Exit Cap Rate	9.0%	9.0%	9.0%	9.0%
Hold Period	8 yrs	6 yrs	8 yrs	8 yrs
LTV	75%	77%	65%	65%
Int	6.5%	6.5%	7.0%	7.0%
Amort	25 yrs	23 yrs	25 yrs	25 yrs
IRR	18.3%	18.3%	22.0%	22.0%

Valuing it on a new 8-year hold, with financing at a lower LTV and higher interest rate, as well as a higher equity yield expectation of 22%, the hotel's value declines to \$47 million (22% below the original acquisition price).

If the buyer is unable to obtain financing immediately, and holds the property for two years before leveraging it at reasonable terms, the value plummets to \$38.9 million (a 35% drop from \$60 million).

This analysis illustrates the difficulty in valuing assets today. Accurately defining all the investment parameters involves a lot of guesswork. In these scenarios, we kept many variables equal, yet the market value still wavers significantly in our two sell scenarios, ranging from 65% to 78% of the market value two years ago. Raising the terminal cap rate, prolonging the recovery period, and increasing the debt and equity yields would clearly result in further deterioration of value.

MANHATTAN SELECT-SERVICE HOTELS CONTINUE TO LURE INVESTORS

In contrast to the market slowdown, there has been ample activity among moderate-tier properties in New York City recently. In the past six months, five hotels traded for hefty price tags in the range of \$317,000 to \$450,000 per key. In total, these transactions accounted for more than \$450 million in investments. In other words, five select-service hotel trades in New York surpassed the total dollar volume of upscale and lux-

ury deals nationwide over the past six months. Moreover, this is in spite of the fact that RevPAR in Manhattan has been leading the nation in declines (down 25% + through the first quarter 2009; down 39.6% in the last week of March). Regardless, the city continues

to attract buyers who are willing to pay a high entry fee to own hotel real estate in a prime global location. And with many travelers of late trading down to more value-priced accommodations, select-service properties in top destinations are viewed as safer investments.

Property	Price	Price/Rm
Hilton Garden Inn West 35th Street	\$121,200,000	\$406,711
Fairfield Inn Times Square South	99,500,000	407,787
Best Western President	150,000,000	449,102
Wyndham Garden Inn Chelsea West	40,300,000	325,000
Hampton Inn Empire State Building	46,340,000	317,397



The 244-room Fairfield Inn in New York was acquired for almost \$100 million.

PHOTO COURTESY:
MARRIOTT INTERNATIONAL



RESIDENTIAL MELTDOWN & BANK FAILURES IMPACT LUXURY DEVELOPMENTS

Over the past few years, one of the most prevalent development trends has been luxury hotel/residential mixed-use projects. A strong residential market generated additional returns and created value for many hotels that might not have been feasible on a stand-alone basis. With the collapse of the real estate market, many hotels that anticipated strong residential pre-sales have not been able to secure financing. Additionally, many high-end destination clubs have fallen on hard times, with several filing for bankruptcy. In recent years, luxury developments relied upon these clubs as some of the major residential buyers in their projects. Consequently, there are now a significant number of delayed and cancelled projects. Numerous developments in New York, Chicago, and Las Vegas have been impacted.

The epitome of the residential collapse may be the former site of the Drake Hotel in New York which sits empty as lenders foreclose on a \$482 million loan. In 2006, the Drake was acquired for nearly \$900,000 per room. The structure was subsequently razed to make way for a major residential mixed-use project.

As a result of the changing real estate market, developers are rethinking the composition of for-sale inventory



A sampling of delayed, if not outright cancelled high profile, luxury projects.

in their lodging projects. The Harmon in Las Vegas has scratched the residential component completely and delayed opening until 2010. Other developments are following a similar strategy.

Many new hotel projects have found themselves in trouble prior to breaking ground. The proposed Shangri-La New York and Nobu Hotel & Residence are now in limbo because their primary lender, Lehman Brothers, filed for bankruptcy. The sites of the proposed Mandarin Oriental Chicago and 1 Hotel & Residences New York are facing foreclosure. The site of the proposed Rosewood Telluride recently sold following foreclosure.

Other deals have hit roadblocks in the midst of construction. The \$500 million redevelopment of the Ritz-Carlton Rancho Mirage was also affected by the Lehman bankruptcy. Construction stopped in October with the project reportedly 85%

completed. The 90-story Waterview Tower in Chicago, which was to house the Shangri-La Chicago, halted construction after building 26 floors. (Shangri-La has since pulled out of the project.) The collapse of Anglo Irish Bank caused work to cease on Chicago Spire after merely laying the foundation. The 250 Bowery project in Manhattan is also facing foreclosure with only the foundation in place.

One of the major concerns, or perhaps one of the more enticing prospects for potential buyers, is the fact that there are several high-end properties scheduled to enter the market this year. Certainly these properties will struggle upon opening. With unsold real estate and empty guest rooms, many of these assets will fail to cover debt service. It will be imperative for owners of these newly-constructed hotels to modify loans or seek additional capital in order to avoid a distressed asset situation. As previously men-

tioned, the W Scottsdale and the InterContinental Montecucia are already in foreclosure after only a few months of operation. It is highly likely that several other supply additions will suffer the same fate.

Currently, close to 30 luxury hotels and resorts are slated to open in 2009. The vast majority of the impending additions to supply contain residential units. Some have already entered the market, like the Capella Telluride and the Viceroy Icon Brickell in Miami.

The effect of the financial crisis on new hotel projects will undoubtedly benefit the existing supply during the inevitable economic recovery. With supply growth waning, the eventual rebound on room night demand should quickly result in occupancy improvement.



2008 OPERATING STATS FOREBODING

To no one's surprise, the final quarter of 2008 had tremendous impact on the overall annual performances of the publicly-traded hotel companies. While most had positive, albeit modest improvement year-over-year through the third quarter, the economic turmoil that erupted in September quickly wiped out the gains achieved earlier in the year.

For the most part, occupancy was down among most of the major brands and ownership/management

firms. Ritz-Carlton, W, and Wyndham experienced the largest occupancy drops among the brands. Strategic Hotels & Resorts reported the largest decline among owners.

Average rate helped to buoy RevPAR in 2008 as many companies and brands exhibited growth in room rates. Most notably, rate growth for Wyndham, InterContinental (Americas), and Orient-Express (North America) surpassed 3.0%.

REVPAR CHANGE
JAN-SEP 2008:

+0.6%

REVPAR CHANGE
OCT-DEC 2008:

-9.8%

TOTAL REVPAR
CHANGE 2008:

-1.9%

SOURCE:

SMITH TRAVEL RESEARCH

brands and boutique (or "lifestyle") brands experienced some of the greatest declines.

Peninsula, perched at the top of the RevPAR scale, slid 8.9%. Morgans and W dropped 5.3% and 5.6%, respectively. Ritz-Carlton had a decline of 4.7%. Great Wolf had the most significant improvement in RevPAR, albeit a moderate up-tick of 4.4%. Great Wolf was the only brand that reported an increase in both occupancy and ADR.

The overall impact of declining occupancy and modest rate growth resulted in the majority of brands and owners/managers suffering declines in RevPAR. Luxury

Brands	Occ			ADR			RevPAR		
	2008	2007	Δ	2008	2007	Δ	2008	2007	Δ
Peninsula ³	68%	76%	(10.5%)	\$597	\$587	1.6%	\$406	\$445	(8.9%)
Morgans	77%	78%	(1.0%)	\$334	\$349	(4.3%)	\$258	\$273	(5.3%)
Orient-Express ¹	62%	64%	(2.0%)	\$390	\$371	5.1%	\$242	\$236	2.5%
St. Regis/Luxury Collection ¹	65%	67%	(3.0%)	\$362	\$363	(0.2%)	\$235	\$243	(3.2%)
Ritz-Carlton ¹	69%	72%	(4.3%)	\$336	\$337	(0.4%)	\$230	\$241	(4.7%)
Le Meridien ¹	75%	76%	(1.3%)	\$303	\$305	(0.8%)	\$227	\$232	(2.1%)
W ¹	73%	76%	(4.5%)	\$291	\$294	(1.3%)	\$212	\$224	(5.6%)
Loews	N/A	N/A	(2.1%)	N/A	N/A	N/A	\$183	\$186	(1.5%)
Great Wolf	64%	62%	2.3%	\$254	\$249	2.0%	\$161	\$155	4.4%
Westin ¹	71%	73%	(3.2%)	\$190	\$186	1.7%	\$134	\$136	(1.6%)
InterContinental ²	68%	69%	(0.9%)	\$180	\$174	3.2%	\$123	\$121	1.8%
Gaylord	75%	78%	(3.9%)	\$165	\$161	2.6%	\$123	\$125	(1.4%)
Marriott ¹	68%	71%	(3.5%)	\$163	\$161	1.4%	\$111	\$114	(2.2%)
Renaissance ¹	69%	71%	(2.4%)	\$155	\$155	0.3%	\$107	\$109	(2.1%)
Sheraton ¹	68%	70%	(3.4%)	\$149	\$147	1.2%	\$101	\$103	(2.2%)
Wyndham	61%	64%	(4.5%)	\$121	\$112	7.4%	\$74	\$72	2.5%
Crowne Plaza ²	62%	63%	(2.3%)	\$113	\$110	2.9%	\$70	\$71	(0.7%)
Owners/Operators									
Accor ⁴	92%	94%	(2.3%)	\$260	\$256	1.7%	\$238	\$240	(0.8%)
Strategic ³	72%	76%	(5.7%)	\$244	\$241	1.5%	\$175	\$183	(4.2%)
LaSalle	73%	74%	(1.2%)	\$200	\$201	(0.5%)	\$146	\$149	(1.7%)
Host	72%	74%	(3.2%)	\$199	\$198	0.7%	\$143	\$146	(2.7%)
DiamondRock	72%	74%	(3.0%)	\$177	\$177	(0.4%)	\$127	\$131	(3.3%)
Sunstone	75%	77%	(3.5%)	\$160	\$158	1.2%	\$119	\$122	(2.3%)
Ashford	71%	74%	(3.5%)	\$143	\$141	1.3%	\$102	\$104	(2.2%)
Hersha	72%	74%	(2.4%)	\$137	\$131	4.1%	\$98	\$97	1.6%
FelCor	71%	70%	0.9%	\$136	\$136	0.1%	\$97	\$96	1.0%
Interstate	69%	72%	(3.5%)	\$138	\$133	3.8%	\$96	\$95	0.2%
MHI	67%	70%	(4.6%)	\$120	\$119	1.0%	\$80	\$83	(3.7%)
HPT	70%	72%	(2.6%)	\$109	\$108	1.1%	\$76	\$78	(1.6%)
Lodgian	69%	69%	0.3%	\$106	\$107	(1.2%)	\$73	\$74	(0.9%)

¹ North America

² Americas

³ United States

⁴ United States, Upscale



2009 FORECASTS REVISITED

In the Autumn edition of *The Lodging Ledger*, we analyzed the 2009 forecast revisions by the major research firms. In examining their new forecasts, we felt that they were too aggressive given the market conditions and the industry's relatively recent experience during the downturn from 2001 through 2003.

**GENERAL RANGE OF
2009 REVPAR
GUIDANCE BY PUBLIC
LODGING COMPANIES:
-10% TO -15%**
*SOURCE:
SEC FILINGS*

Sure enough, all of these firms released revised and obviously gloomier predictions for 2009. At a minimum, the revised forecasts show RevPAR declines more than double those projected in late 2008.

PKF has issued two revisions in the past four months, and currently has the gloomiest outlook for 2009 with a projected 13.7% decline in RevPAR. STR remains the most optimistic about 2009 with only a 5.9% RevPAR falloff anticipated. PwC is now forecasting a drop of 11.2%.

Although it is easy to criticize projections during down cycles, the constant revisions create even more fodder for commentary. While there is a sincere yearning for guidance amid the market uncertainty, pinpointing specific numbers for occupancy, average rate, and RevPAR changes is almost meaningless. Adjusting the moving target every two or three months compounds the issue. And undoubtedly, next January when 2009 results are tallied, there will

be at least one firm that claims that their umpteenth projection was within a stone's throw of actual performance. Imagine being able to rework your NCAA bracket after every round of March Madness and then being able to claim victory at the end!

	2009 Forecast as of Nov 2008		
	Occ	ADR	RevPAR
STR	-3.5%	+1.0%	-2.5%
PKF	-4.4%	+1.3%	-3.2%
PwC	-3.5%	-2.4%	-5.8%

	Current 2009 Forecast		
	Occ	ADR	RevPAR
STR	-3.9%	-2.0%	-5.9%
PKF	-7.8%	-6.4%	-13.7%
PwC	-6.5%	-5.2%	-11.2%



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Stephen Hennis has over fourteen years of experience in the analysis of lodging investments. He has appraised and evaluated over 500 lodging facilities, and has been involved in the underwriting, negotiation, and acquisition of over \$400 million in luxury hotels and resorts. Prior to becoming Managing Director of Hospitium, Mr. Hennis served as Vice President of Hospitality Investments for Lowe Hospitality Group and Destination Hotels & Resorts where he was involved with acquisitions, dispositions, and development projects. Mr. Hennis previously served as Vice President and Director of Research for HVS International where he specialized in the analysis and valuation of large portfolios for cross-collateralized securitizations and oversaw the redevelopment of HVS' analytical models and report templates. He has also worked for Marriott International and Caesars World. Mr. Hennis is a graduate of the University of Denver's School of Hotel, Restaurant & Tourism Management.

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