

Specialized Real Estate Strategies: HOTELS

14th Annual Fisher Center Real Estate Conference

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Topics:

- Current Situation
- Yesterday, Today, and the Future
- The Question of Value
- Transactions: When and How?
- Observations and Pet Peeves

Current Situation

- Declining Occupancy (-10.5% 2009 YTD), Declining Room Rates (-6.5% 2009 YTD), Decimated EBITDA (-30% 2009 YTD)
- Erosion of Hotel Values (Cap Rate + EBITDA = 50%+)
- Impending Mortgage Defaults
- Little or No Financing Available
- No New Significant Supply
- Slow Path to Re-Stabilization
- Strong Potential Buying Opportunity

Yesterday, Today, and Tomorrow

- Recessions:
- 1973 -75 (High Oil Prices, Mortgage REIT Failure, Hotel Overbuilding - +16.9% in 1974, +45% over three years),
- 1980 - 82 (Energy Crisis, High Interest and Inflation, Low Travel Demand, Limited New Hotel Supply - +4.7% in 1981)
- 1990 - 91 (Industrial Decline, S&L Crisis, Massive Hotel Late 80's/Early 90's Overbuilding - +17% in 1989, +80% over five year period),
- 2001 - 2003 (Dot.com Bomb, Terrorist Attack, Late 90's Hotel Overbuilding - +13% in 1999, +48% from 1998 - 2001),
- 2007 (High Oil Prices, Industrial Decline, Credit Crunch, Shrinking Economy, Limited New Hotel Supply - +7.5% in 2009)

Yesterday, Today, and Tomorrow – Supply vs. Occupancy

- Historically, <1.5% Annual Hotel Room Supply Growth in First Four Years After Recessionary Periods
- Projected Annual Growth for Hotel Room Supply < 1.0% Between 2010 and 2014
- Projected Occupancy Decline: -8.5% in 2009, -2% in 2010
- Projected Occupancy Increases: +2.5% in 2011, +3.5% in 2012, +4.5% in 2013, +4.0% in 2014 based on 1980's recovery pattern with similar supply conditions
- 2015 Occupancy = 2007 Occupancy = 63.5%

Yesterday, Today, and Tomorrow – Room Rates

- Average Daily Rates (ADR) Declined Only in Two Years since 1970: 2001(-1.4%) and 2002 (-1.5%)...Until 2009.
- Ongoing Lower Occupancy = ADR Deceleration
- ADR Acceleration Trails Renewed Occupancy Increase by 12 months
- ADR Forecast: -7.5% in 2009, >-1.0% in 2010, +1.0% in 2011, 3% in 2012, >5% in 2013, 2014, and 2015.

Yesterday, Today, and Tomorrow – House Profit (GOP)

- Revenue (REVPAR) Declines Accompanied By Accelerated GOP Decline
- REVPAR/GOP Comparisons in 2001 Recession: -22% REVPAR/-32% GOP between 2000 and 2002 (All Segments)
- REVPAR/GOP Forecast in 2009 Recession: -28.5% REVPAR/-47% GOP between 2008 and 2009 (All Segments)
- Highest declines in Upscale/Luxury Segments

Transactions:

Question of Value

- 2005 – 2007: Three-Year Average is 270 annual U.S. Hotel Asset Sales
- 2008: 114 Sales, - 8.6% Per Room Sale Price
- Cap Rate Comparisons: 6%-7% in 2007 vs. 9%-10% in 2009
- EBITDA Decline in 2009: >40% Forecast
- Cap Rate + EBITDA Decline = >50% Value Decline From 2007?? (Probably Not)
- Historical Reference: 23% Per Available Room Value Decline in 2002 on 30% EBITDA Decline

Transaction Issues

- REVPAR Trends Determine Extent of Decline
- Availability and Cost of Credit
- Emergence and Timing of Distressed Hotel Real Estate....Pressure on Sellers
- Bid/Ask Gap between Sellers and Buyers...20% - 50%
From 2007 Value Declines
- Risk Tolerance of Buyers in Recovering Market Conditions

Observations and Pet Peeves - #1

- Historic Views, Past Recessions (2001), and Respected Research Indicate that Lowering Room Rates Rarely Stimulates Demand.....Yet Discounting Abounds in 2009.....Hotels Claim Market Share Strategy!
- Net Result of Discounting: Accelerated Profit Decline, Accelerated Real Estate Value Decline, Undermining of Brand Value, and Long Term Impact on Pricing Power
- Result of Room Rate Discounting: National REVPAR in 2000 = \$53.79, 2010 Forecast = \$54.85. (Source: Smith Travel Research)

Observations and Pet Peeves - #2

- 2009 Does Not Fully Exhibit Impact of Declining Commercial and Negotiated Room Rates.
- Airline Lift or Lack Thereof Impact Resort Growth or Lack Thereof.
- Inability of Hotel Owners to Refinance May Lead to Quick Disposition and Bargain Values.
- Lenders May Gain Little or No Value in Foreclosure

Observations and Pet Peeves - #3

- Intense and Successful Expense Management Leave REVPAR Increase Only Means for Profit Growth.
- Accuracy of Appraisal or Valuation in 2009 = ??????????
- Best Buying Opportunities Begin.....Very Soon.
- Fundamentals of Location, Demand Diversity, Brand, and Barriers are Priority versus Liquidation Pricing.

Lean and Mean Until 2013?

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