What’s Up with Hotel Values & CAP Rates

Meet The Money 2010

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What Kind of Hotel and Location?

- Who is the likely buyer and what is their source of capital?
- Quality, cash flowing full service asset in a first tier market?
  - Cap rates trending down
- Aging limited service hotel with no or limited cash flow in an overbuilt, secondary or tertiary market?
  - All cash purchase at elevated cap rates
- Something in between?
  - Depends on specifics of the asset. Numerous buyers frustrated with the competition for first tier assets are starting to look at less other alternatives

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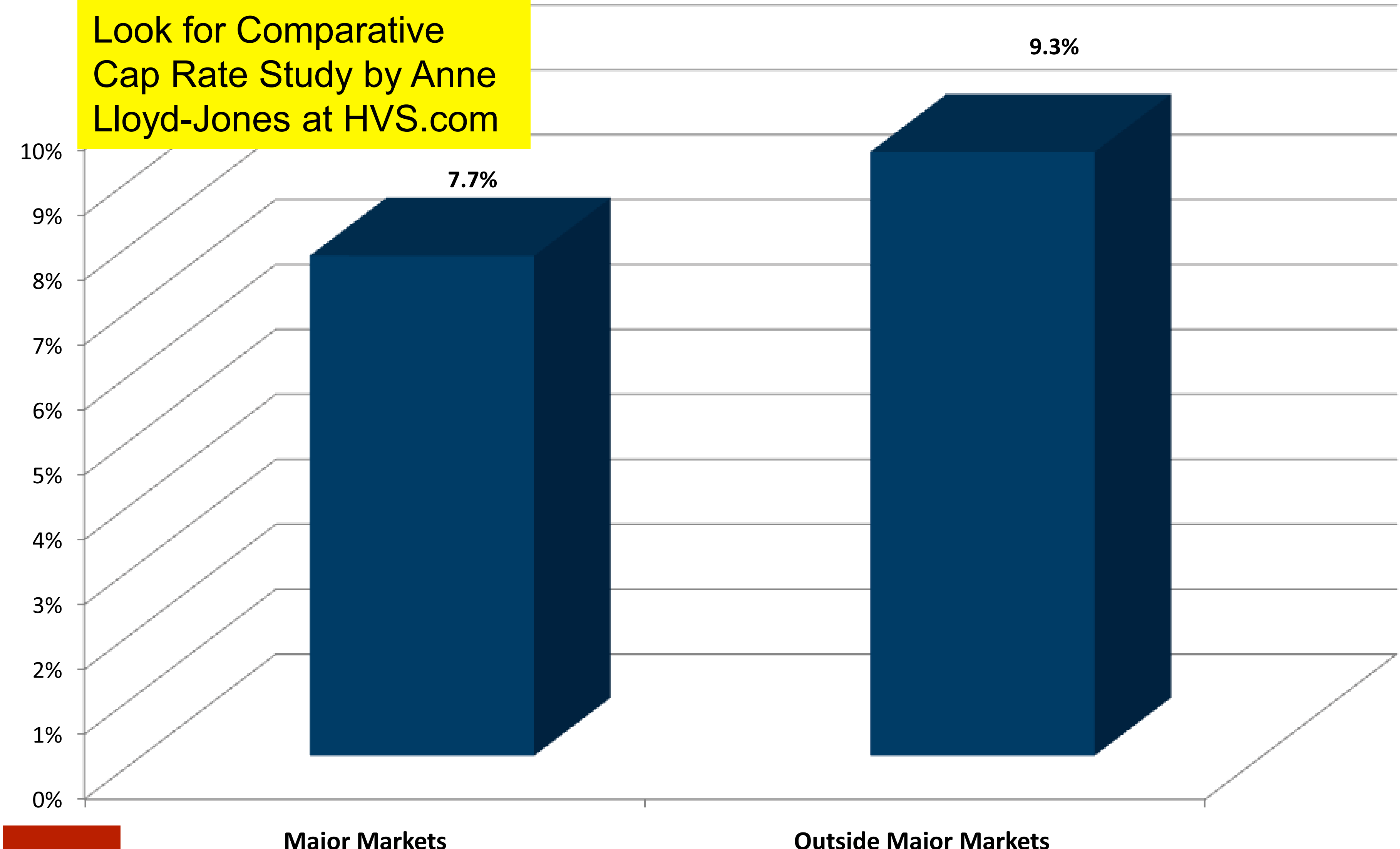
HVS Comparative Cap Rate Study
by Anne-Lloyd Jones of HVS NY
www.hvs.com

- Cap rates derived from sales from 2000 through 2009
- Based on historical net income at time of sale
- Study was performed to show the relative positioning in cap rates
- SHOULD NOT BE USED AS A BASIS FOR SELECTION OF CAP RATES BY INVESTORS, LENDERS, BROKERS OR APPRAISERS
- Cap rates reflect historic low levels of debt and equity capital

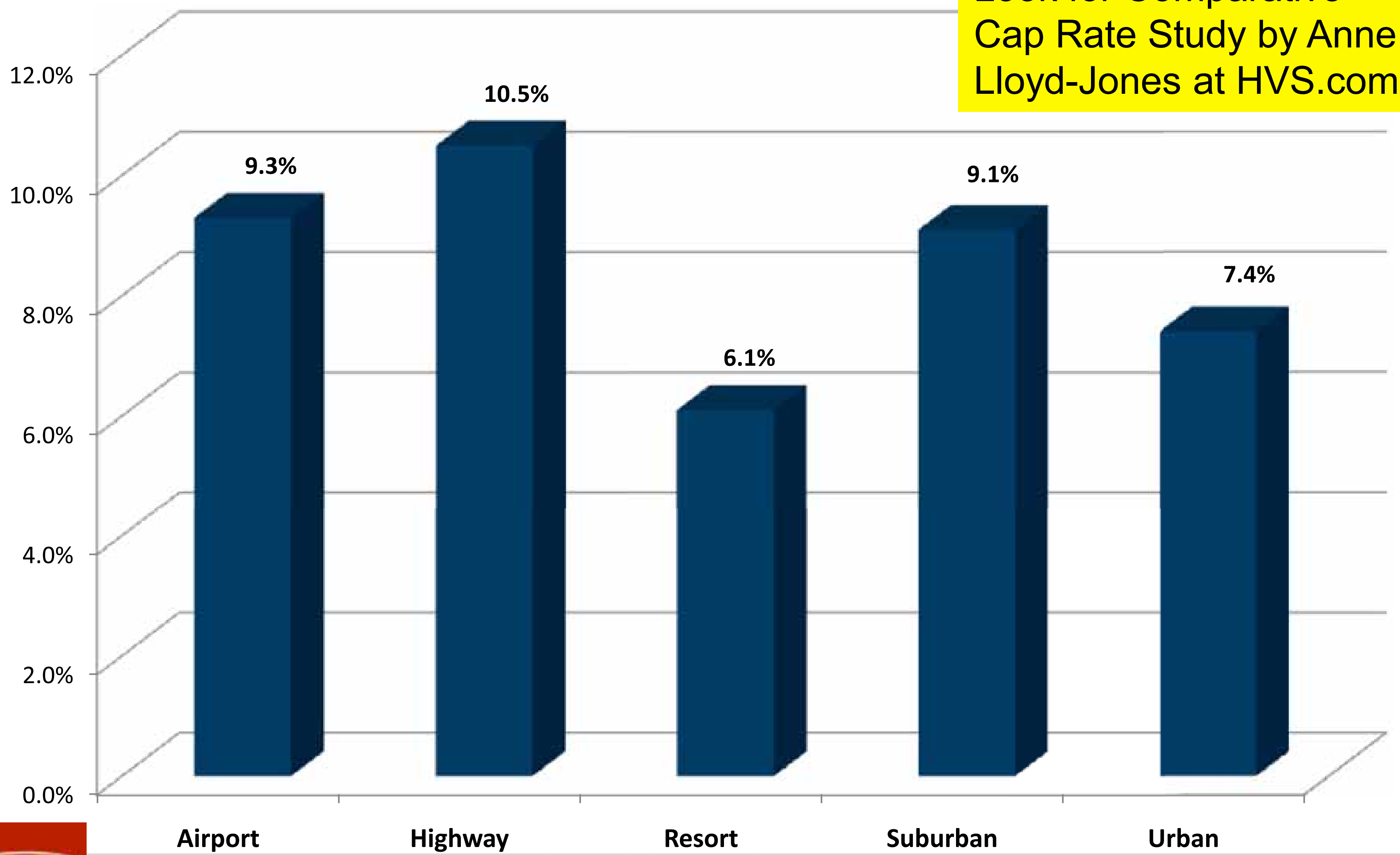
Median Overall Cap Rate 2000–2009
25 Major Markets vs. Non-Major Markets

Look for Comparative Cap Rate Study by Anne Lloyd-Jones at HVS.com



Source: HVS

Median Overall Capitalization Rate by Location, 2000-2009



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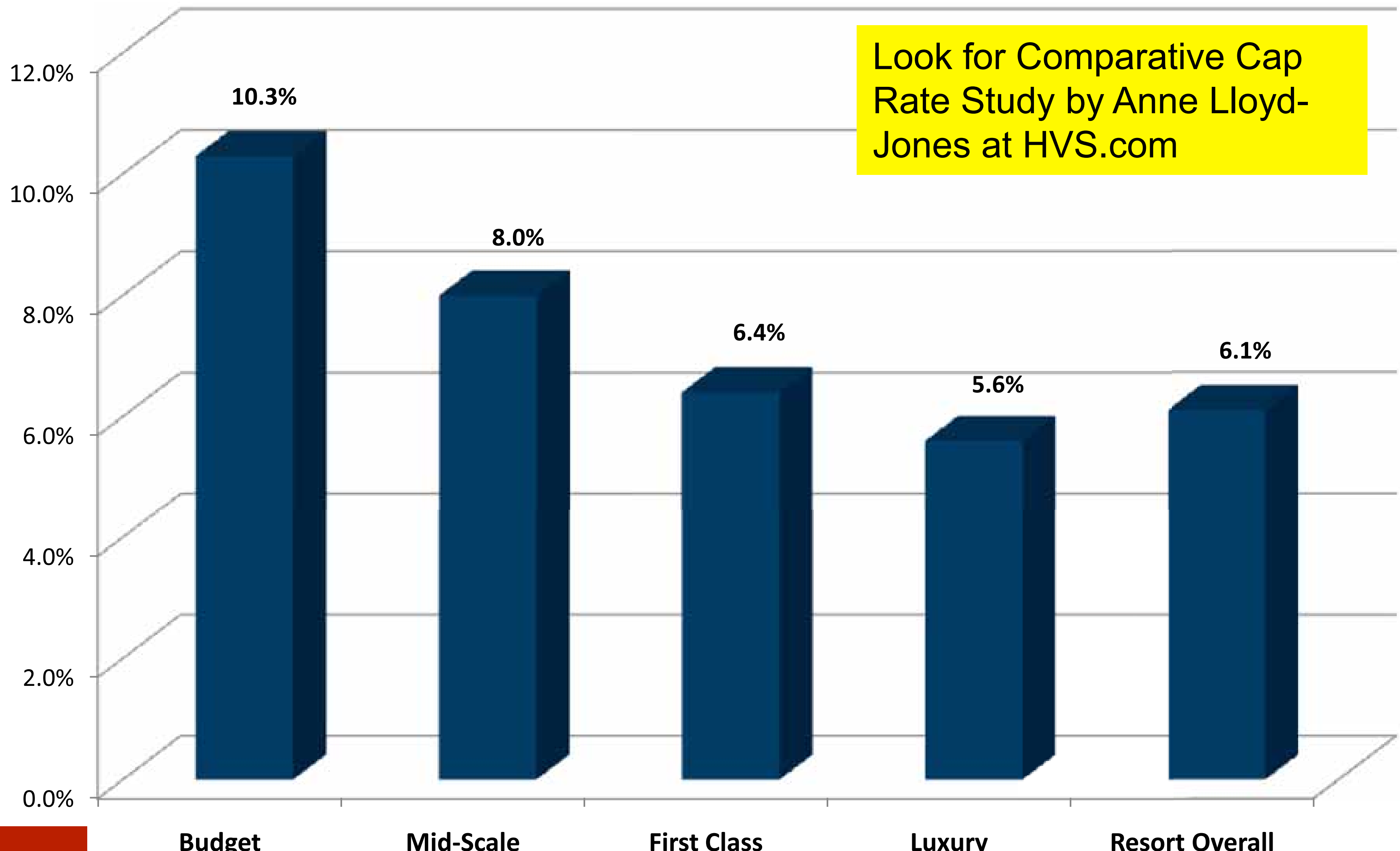
Source: HVS

Median Capitalization Rates
Resort Locations by Tier, 2000-2009



Source: HVS

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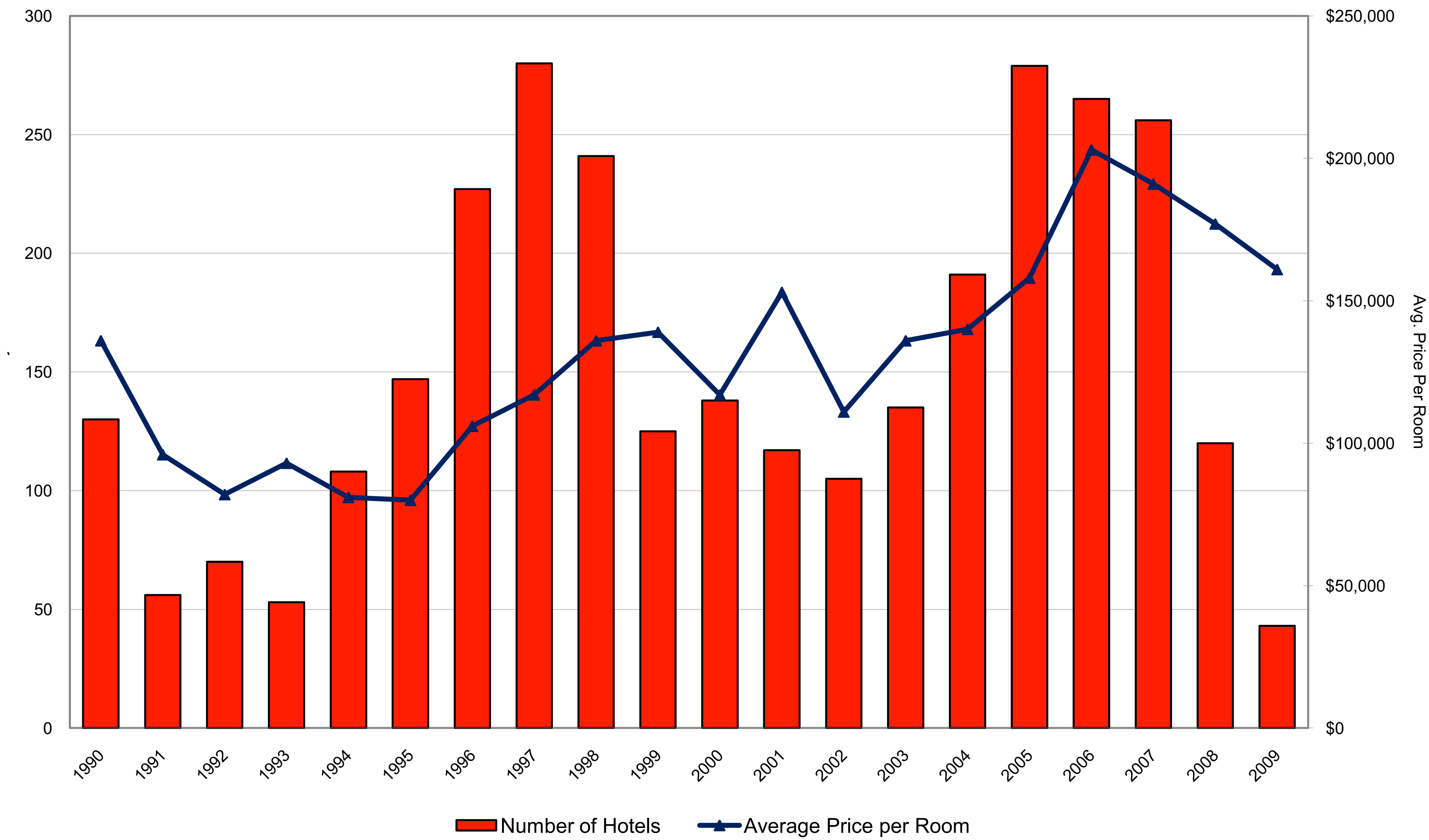
Major Sales Transactions (>$10 Million)



Source: HVS

Major Hotel Sales Transactions

Year	Number of Hotels		Avg. Price Per Room	% Change
1990	130		$136,000	
1991	56	-56.9 %	96,000	-29.4 %
1992	70	25.0	82,000	-14.6
1993	53	-24.3	93,000	13.4
1994	108	103.8	81,000	-12.9
1995	147	36.1	80,000	-1.2
1996	227	54.4	106,000	32.5
1997	280	23.3	117,000	10.4
1998	241	-13.9	136,000	16.2
1999	128	-46.9	148,000	8.8
2000	150	17.2	116,000	-21.6
2001	105	-30.0	146,000	25.9
2002	106	1.0	111,581	-23.6
2003	142	34.0	132,944	19.1
2004	189	33.1	136,056	2.3
2005	331	75.1	168,225	23.6
2006	270	-18.4	201,935	20.0
2007	252	-6.7	192,566	-4.6
2008	114	-54.8	176,067	-8.6
2009	43	-62.3	127,891	-27.4
YTD 3/31/09	7	N/A	310,856	N/A
YTD 3/31/10	13	-85.7 %	200,661	-35.4 %

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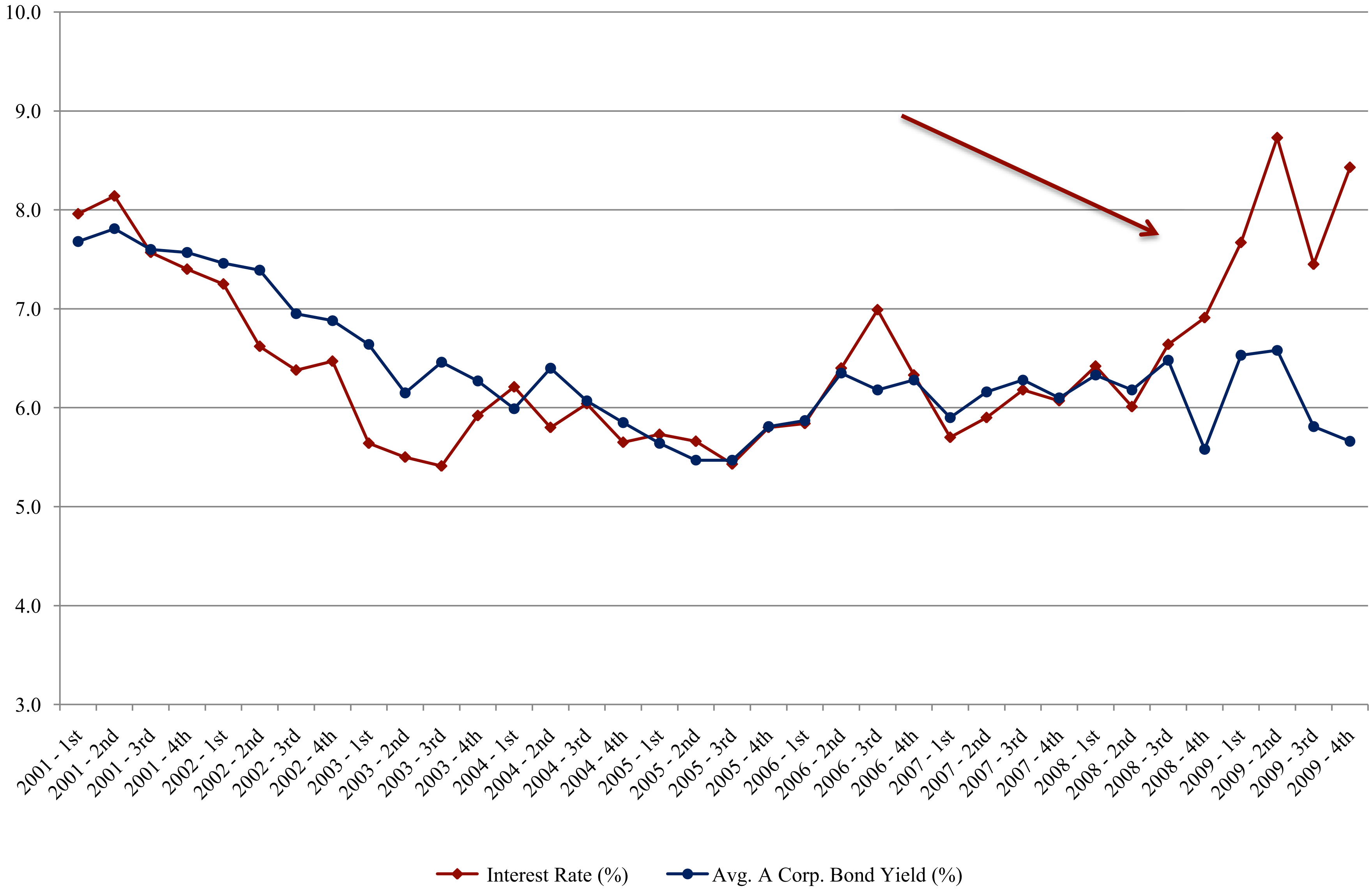
Cap Rates: Reflection of Cost and Availability of Debt and Equity

- Lending is starting to resume
- Significant equity capital on the side line waiting for opportunities
- While investors say their return requirements have increased, transaction activity indicates otherwise
- Equity return requirements depend upon asset, its current NOI and its prospects for the future
- Disconnect between surveyed capitalization rates and cap rates derived from actual sales
- Surveyed discount rates are in line with discount rates derived from sales and pro-formas

Hotel Mortgage Interest Rates



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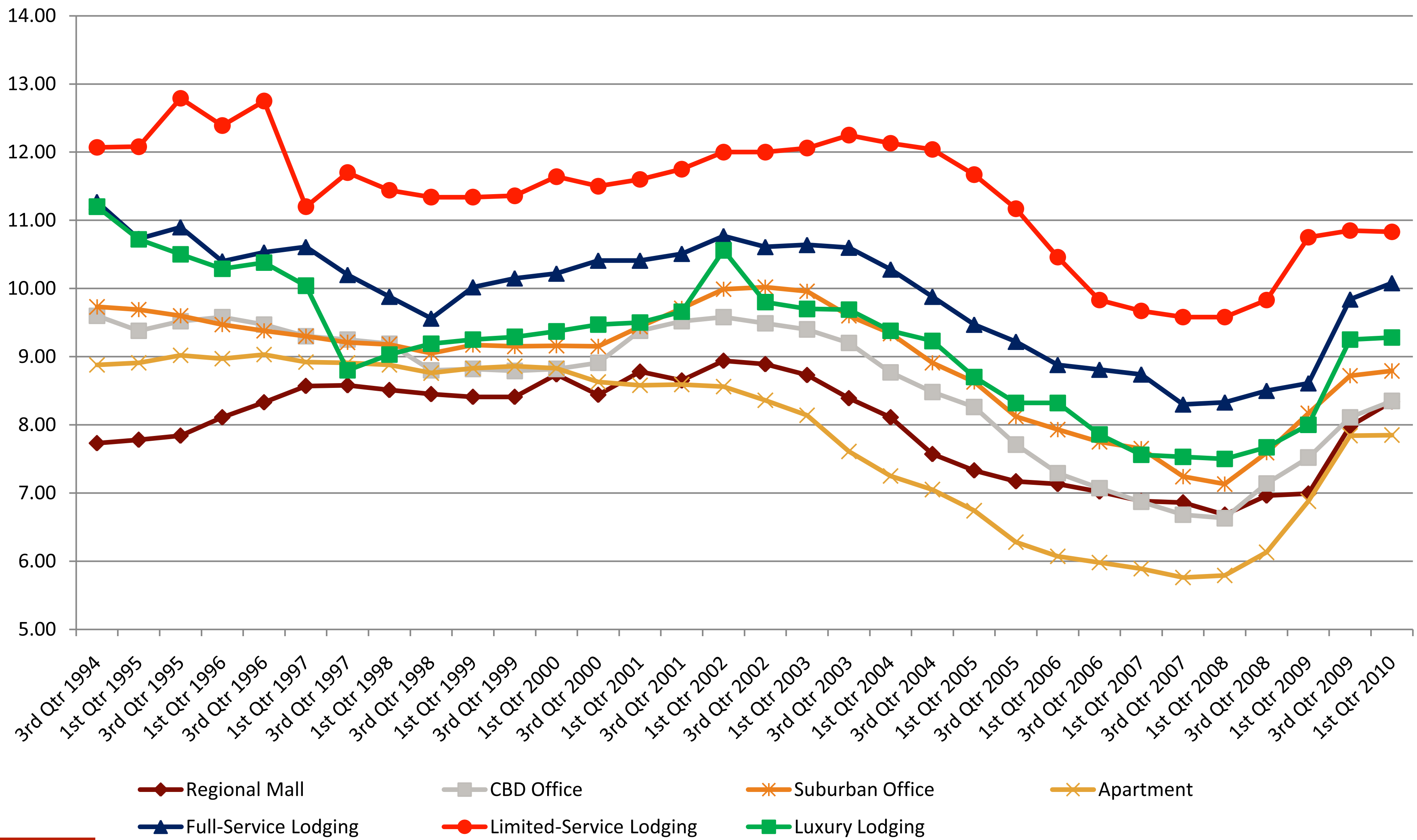
The Debt Component

- Absence of readily available capital impacting hotel values
- Many transactions must be all cash
- Debt capital starting to reappear
- Sources of debt:
  - Insurance companies
  - Hard money lenders
  - Seller financing
  - Commercial banks
  - CMBS coming back and starting to look at hotel deals

Equity Component

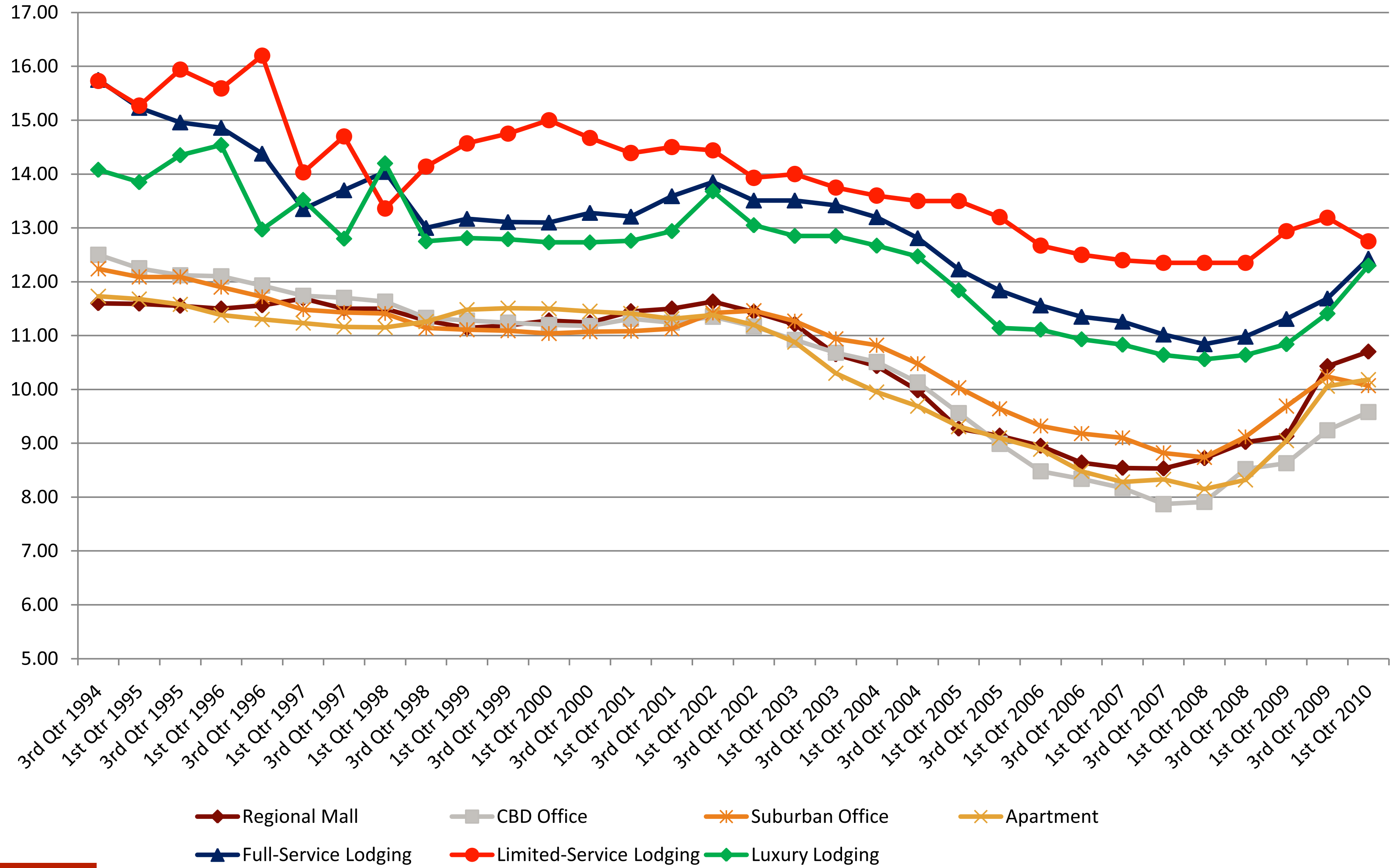
- Numerous funds on the side line waiting for opportunities
- While investors will say their return requirements have increased, the competition for quality assets indicates otherwise
- Equity return requirements depend upon asset, its current NOI and its prospects for the future

Cap Rate Comparison



Source: PWC Korpacz Investor Survey

Discount Rate Comparison



Source: PWC Korpacz Investor Survey

Historical Cap Rates – Select Set of Full Service Hotels

	Cap Rate based on Historical NOI	Cap Rate based on 1st Yr. Projected NOI	Free and Clear Discount Rate	Equity Yield
2010	6.6	6.6	13.0	17.1
2009	8.0	6.4	13.7	16.9
2008	6.6	5.3	11.9	20.0
2007	6.0	6.8	11.6	21.3
2006	5.5	5.7	10.8	18.9
2005	5.2	6.9	11.4	19.7
2004	5.8	7.4	12.2	19.7
2003	7.9	8.2	14.0	21.4
2002	8.9	9.8	13.6	21.0
2001	8.2	9.8	14.6	22.2
2000	9.2	10.4	14.0	21.0
1999	10.3	11.4	15.5	24.9
1998	8.8	9.7	14.5	22.2
1997	9.3	10.5	15.4	23.9
1996	7.0	9.8	13.5	21.4
1995	7.0	11.1	14.1	20.5
1994	5.7	8.3	14.8	21.8
1993	8.5	12.0	20.8	34.3
1992	4.8	7.7	15.1	21.9
1991	6.4	8.9	19.4	24.0
1990	8.0	10.0	15.1	22.4
1989	9.5	9.4	17.6	28.8
1988	9.1	9.7	14.7	21.4

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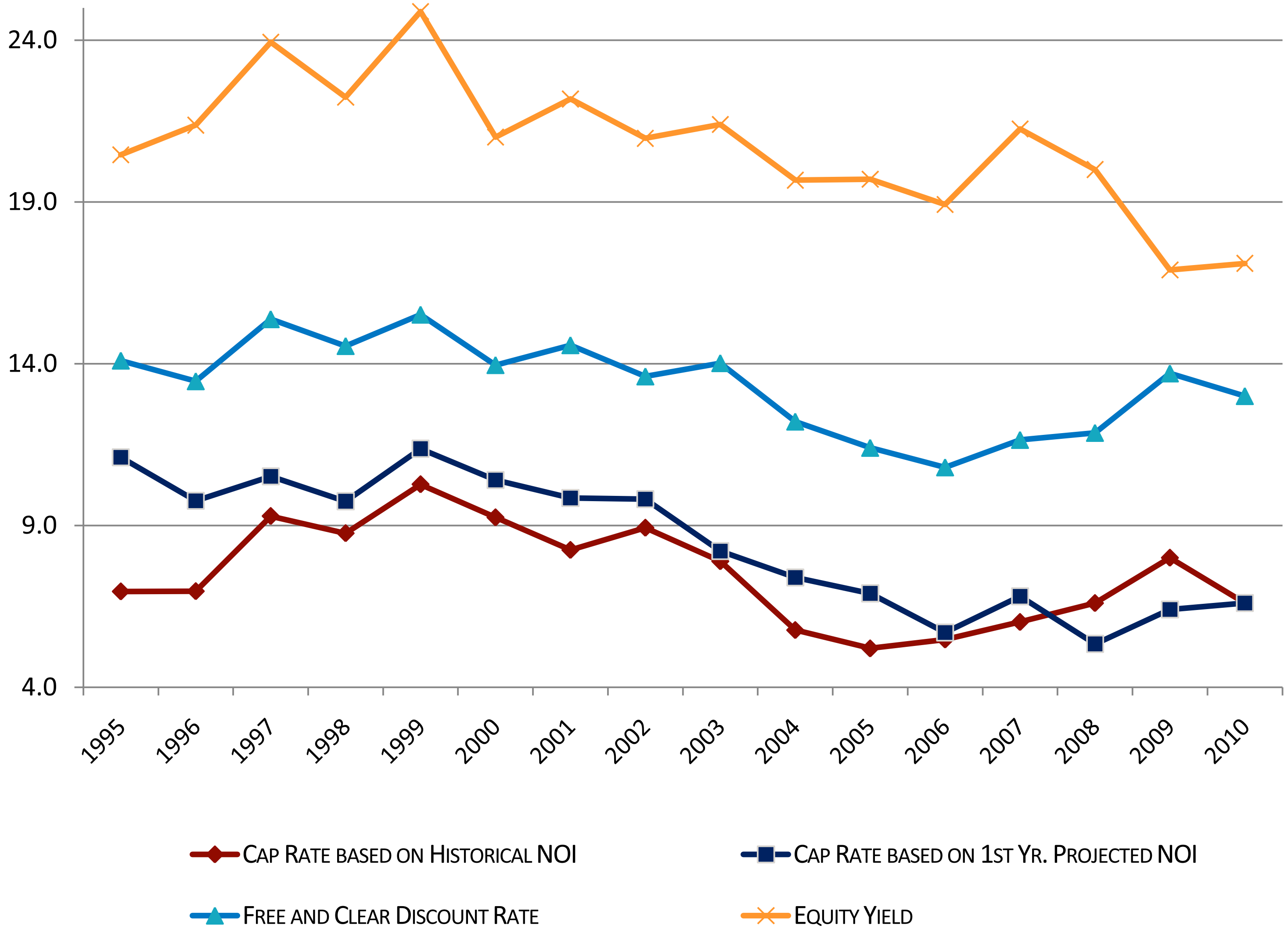
Source: HVS - San Francisco

Capitalization and Discount Rates – Select Set of Full Service Hotels



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Factors that Impact Discount Rate or Internal Rate of Return

- Timing of the cash flows – how long will it take for the asset to recover?
  - The larger and longer the projected recovery, the higher the discount rate will be / should be
- What is the source of capital for the likely purchaser of the hotel in question?
- What are the investor's equity return requirements?
- Who are your investors competing against for their acquisitions?
- Discount rates are declining for quality assets due to competition amongst buyers that have access to public capital and/or are mandated to invest

Survey of Investment Return Requirements for High Quality Hotel Assets

- Equity Yields of High Teens to Low 20's
- Debt at 50% to 60% LTV today
- Debt cost 8% to 9%
- Funds and REITS are competing for assets at 11% to 11.5% unlevered returns
- Does the math work? What is the true equity yield?

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Valuation of Moderately Impacted Asset Assuming 50% Leverage Upon Sale

Valuation Input	
Stabilized Year:	5
Inflation:	3.0%
Loan/Value:	50%
Amortization:	25
Term:	10
Interest Rate:	8.50%
Terminal Cap Rate:	9.0%
Transaction Costs:	2.0%
Equity Yield:	18.0%

Valuation Output	
Value:*	$25,600,000
Value Per Room:	$170,667
Overall Discount Rate:	14.2%
Cap Rate - Historical NOI:	8.8%
Cap Rate - 1st Year NOI:	8.1%
Mortgage @ 50.0% LTV:	12,786,000
Mortgage Per Room:	85,240
Annual Debt Service:	1,235,000
Debt Coverage Ratio - Year 1:	1.67

Refinancing at End of 2013

Valuation Input	
Year of Value:	2013
Inflation:	3.0%
Loan/Value:	70%
Amortization:	25
Term:	10
Interest Rate:	8.5%
Terminal Cap Rate:	9.0%
Transaction Costs:	2.0%
Equity Yield:	18.0%

Valuation Output	
Value:*	$33,100,000
Value Per Room:	$220,667
Overall Discount Rate:	12.2%
Cap Rate - Historical NOI:	6.8%
Cap Rate - 1st Year NOI:	8.7%
Mortgage @ 70.0% LTV:	23,147,000
Mortgage Per Room:	154,313
Annual Debt Service:	2,237,000
Debt Coverage Ratio - Refi Year:	1.28

*Before capital deduction, if any

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Refinancing and Sales Proceeds

Refinancing Year Value:	$33,100,000
New Loan/Value Ratio:	70%
New Mortgage:	23,147,000
Less:	
Outstanding Balance of Initial Mortgage:	11,860,000
Refinancing Costs @ 1.0%:	231,000
	$11,056,000

11th Year's Net Income:	$4,215,338
Loaded Terminal Capitalization Rate	10.1%
Total Sales Proceeds:	41,591,477
Less: Outstanding Mortgage Balance:	20,584,942
Less: Transaction Costs @ 2.0%:	831,830
	$20,174,706

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Net Income to Equity

Year	Net Income Available for Debt Service		Total Annual Debt Service		Plus: Refi/Sale Proceeds		Total Cash Flow to Equity
2010	$2,057,000	-	$1,235,000	+	$0	=	$822,000
2011	2,228,000	-	1,235,000	+	0	=	993,000
2012	2,477,000	-	1,235,000	+	11,052,000	=	12,294,000
2013	2,943,000	-	2,237,000	+	0	=	706,000
2014	3,224,000	-	2,237,000	+	0	=	987,000
2015	3,327,000	-	2,237,000	+	0	=	1,090,000
2016	3,432,000	-	2,237,000	+	0	=	1,195,000
2017	3,540,000	-	2,237,000	+	0	=	1,303,000
2018	3,653,000	-	2,237,000	+	0	=	1,416,000
2019	3,768,000	-	2,237,000	+	20,175,000	=	21,706,000

Discounted Net Income to Equity

Year	Net Income To Equity	Equity Discount	Discount Factor	Discounted Cash Flow
2010	$822,000	18.0%	0.84746	$696,610
2011	993,000	18.0%	0.71818	713,157
2012	12,294,000	18.0%	0.60863	7,482,508
2013	706,000	18.0%	0.51579	364,147
2014	987,000	18.0%	0.43711	431,427
2015	1,090,000	18.0%	0.37043	403,770
2016	1,195,000	18.0%	0.31393	375,140
2017	1,303,000	18.0%	0.26604	346,648
2018	1,416,000	18.0%	0.22546	319,246
2019	21,706,000	18.0%	0.19106	4,147,245

Value of Equity Component:	$15,279,899
Plus: Value of Initial Mortgage:	12,785,648
Less: Capital Deduction:	0
Total Property Value:	$28,065,546
Rounded To:	**$28,100,000**

Overall Discount Rate

Year	Net Income Available for Debt Service		Discount Factor 12.7%	Discounted Cash Flow
2010	$2,057,000		0.88719	$1,824,949
2011	2,228,000		0.78711	1,753,671
2012	2,477,000		0.69831	1,729,719
2013	2,943,000		0.61954	1,823,292
2014	3,224,000		0.54965	1,772,057
2015	3,327,000		0.48764	1,622,377
2016	3,432,000		0.43263	1,484,783
2017	3,540,000		0.38382	1,358,737
2018	3,653,000		0.34052	1,243,937
2019	44,527,648	*	0.30211	13,452,250
			Estimated Market Value	$28,065,773
			Rounded To	**$28,100,000**

Reversion Analysis

11th Year's Net Income	$4,216,000
Capitalization Rate	9.0%
Total Sale Proceeds	$46,844,444
Less: Transaction Costs @ 2.0%	831,960
Net Sales Proceeds	$40,766,051

*10th year net income of $3,743,000 plus sales proceeds of $40,766,000

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Impact of Lower Unlevered Discount Rate

Year	Net Income Available for Debt Service		Discount Factor 11.0%	Discounted Cash Flow
2010	$2,057,000		0.90084	$1,853,028
2011	2,228,000		0.81151	1,808,051
2012	2,477,000		0.73104	1,810,794
2013	2,943,000		0.65855	1,938,122
2014	3,224,000		0.59325	1,912,641
2015	3,327,000		0.53442	1,778,030
2016	3,432,000		0.48143	1,652,271
2017	3,540,000		0.43369	1,535,270
2018	3,653,000		0.39069	1,427,181
2019	44,527,648	*	0.35195	15,671,362
			Estimated Market Value	$31,386,749
			Rounded To	**$31,400,000**

Reversion Analysis

11th Year's Net Income	$4,216,000
Capitalization Rate	9.0%
Total Sale Proceeds	$46,844,444
Less: Transaction Costs @ 2.0%	831,960
Net Sales Proceeds	$40,766,051

*10th year net income of $3,743,000 plus sales proceeds of $40,766,000

Cash Flow to Equity at Value Based on 11% Discount Rate

Year	Net Income Available for Debt Service		Total Annual Debt Service		Plus: Refi/Sale Proceeds		Total Cash Flow to Equity
2010	$2,057,000	-	$1,407,000	+	$0	=	$650,000
2011	2,228,000	-	1,407,000	+	0	=	821,000
2012	2,477,000	-	1,407,000	+	11,483,000	=	12,553,000
2013	2,943,000	-	2,439,000	+	0	=	504,000
2014	3,224,000	-	2,439,000	+	0	=	785,000
2015	3,327,000	-	2,439,000	+	0	=	888,000
2016	3,432,000	-	2,439,000	+	0	=	993,000
2017	3,540,000	-	2,439,000	+	0	=	1,101,000
2018	3,653,000	-	2,439,000	+	0	=	1,214,000
2019	3,768,000	-	2,439,000	+	18,312,000	=	19,641,000

Equity Yield Reduced to 14.5% from 18.0%

Year	Net Income To Equity	Equity Discount	Discount Factor	Discounted Cash Flow
2010	$650,000	14.5%	0.87336	$567,686
2011	821,000	14.5%	0.76276	626,228
2012	12,553,000	14.5%	0.66617	8,362,403
2013	504,000	14.5%	0.58181	293,230
2014	785,000	14.5%	0.50813	398,880
2015	888,000	14.5%	0.44378	394,076
2016	993,000	14.5%	0.38758	384,867
2017	1,101,000	14.5%	0.33850	372,686
2018	1,214,000	14.5%	0.29563	358,897
2019	19,641,000	14.5%	0.25819	5,071,177

Value of Equity Component:	$16,830,128
Plus: Value of Initial Mortgage:	14,556,562
Less: Capital Deduction:	0
Total Property Value:	$31,386,691
Rounded To:	**$31,400,000**

Value Recovery for a Sample Hotel

- 200 room hotel generating $2,500,000 in NOI valued at a 7% cap rate in 2007 was worth $35.7 million or $178,000 a room
- Hotel's NOI declined by 35% to $1,625,000 in 2009; cap rate increased by 200 bp to 9%, value declines by 50% to $18.0 million or $90,000 a room
- If cap rate is driven down to historical levels, value has already recovered 30% of value loss: $116,000 per room
- If hotel's NOI recovers to $2,500,000 by 2013, a cap rate of 7% is required for the value to have fully recovered its value in nominal dollars – with no adjustment for inflation
- Future value of $35.7 million adjusted for 3% annual inflation equates to $30 million or $150,000 a room in 2007 dollars
- If cap rates increase to 8.5% due to rising capital costs and/or a less competitive investment market value will have recovered to $29.4 million, or $147,000 a room in nominal dollars and $123,000 a room in inflation adjusted dollars.

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Suzanne R. Mellen is Senior Managing Director of Consulting & Valuation for HVS San Francisco and Las Vegas and President of HVS Gaming Services. HVS is a full-service consulting and valuation firm specializing in hotel, gaming, and hospitality properties worldwide. Under Ms. Mellen's leadership, HVS San Francisco and Las Vegas have become renowned for excellence and integrity. Suzanne Mellen's professional experience includes consulting and appraisal positions with HVS New York, Morgan Guaranty Trust, Laventhol & Horwath, and Helmsley-Spear Hospitality Services, Inc. in New York City and Harley-Little Associates in Toronto, Canada. She gained her operational experience at the Plaza Hotel in New York.

Ms. Mellen has a B.S. degree in Hotel Administration from Cornell University and holds the following designations: MAI (Appraisal Institute), CRE (Counselor of Real Estate), FRICS (Fellow of the Royal Institution of Chartered Surveyors), and ISHC (International Society of Hospitality Consultants). She has been appraising hotels, gaming assets and related real estate for over 30 years, has authored numerous articles, and is a frequent lecturer and expert witness on the valuation of hotels, casinos and related issues. She developed the Simultaneous Valuation Formula, a mortgage-equity income capitalization formula for variable income properties, and developed the software for the model.