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HOTEL TRANSACTION ACTIVITY SLOWS, CAP RATES RISE

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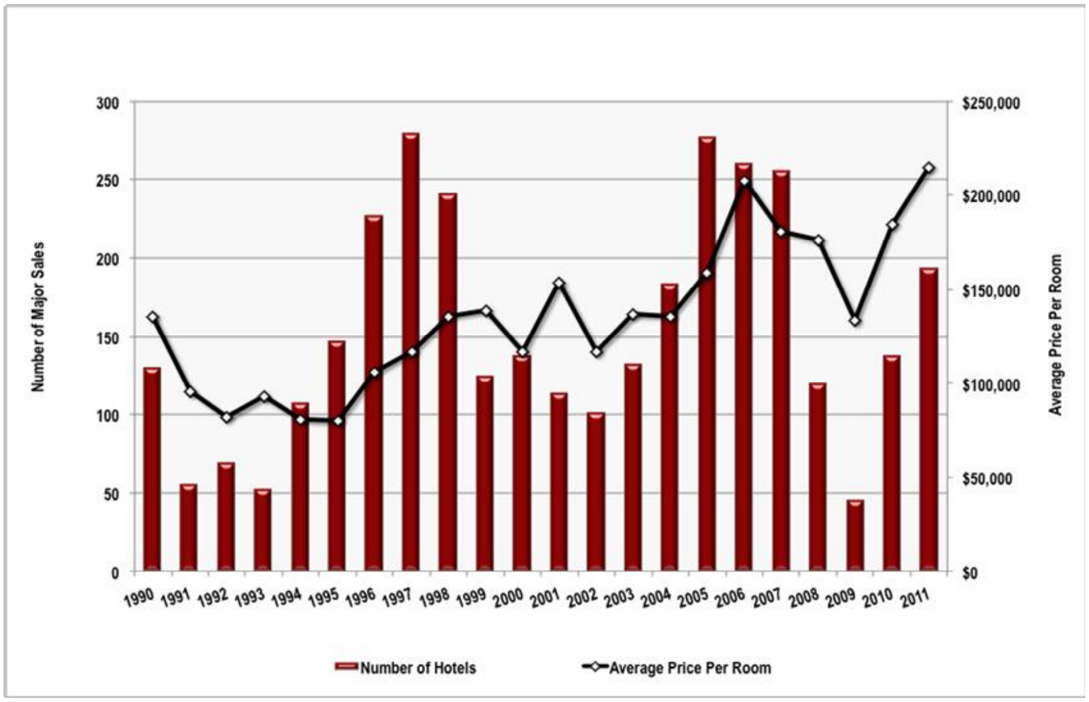
Hotel Transaction Activity Slows, Cap Rates Rise

Major hotel sales activity was robust during the first half of 2011, as investors jumped in to reap the rewards of rebounding NOI in the aftermath of the Great Recession. The US debt ceiling debacle and bond rating downgrade, followed by the European financial crisis put the brakes on many transactions during the summer and fall of 2011. Major hotel sales transactions activity has resumed but will continue to face headwinds in 2012 due to continuing economic and political uncertainty.

Hotel Sales Transactions Market Changed Course in Mid-2011

Total transactions of sales $10 million and over, that HVS has confirmed to date, jumped 40% in 2011, following the 80% gain in 2010 over the 2009 market nadir. The average price-per-key increased by 16% from $185,000 to $214,000.

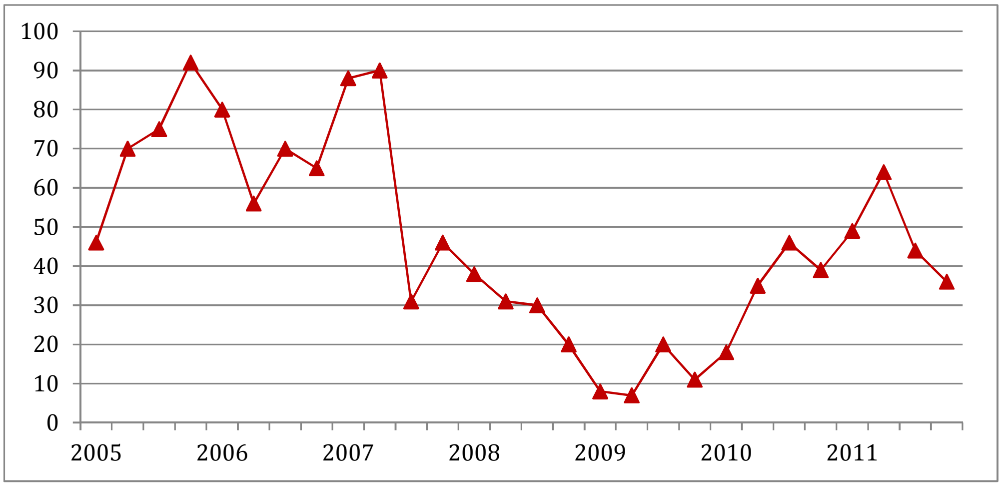
MAJOR HOTEL SALES TRANSACTIONS



Source: HVS

Sales had come to a virtual standstill in 2009 as hotel revenues and net incomes plummeted in the aftermath of the fall 2008 US debt crisis. Once it became clear that the market had bottomed out and hotel net incomes had nowhere to go but up, hotel transactions resumed in the second quarter of 2010. With the perception of reduced risk in the lodging sector, lenders jumped in, providing the financing to lubricate the market. Sales activity steadily increased throughout the remainder of 2010 and the first two quarters of 2011, before the US debt downgrade and European financial crisis caused transactions to stall in third quarter of the year. The recent volatility of the market is evidenced in hotel sale transactions trends, set forth by quarter in the following chart.

MAJOR SALES ACTIVITY BY QUARTER



Source: HVS

Some highlights of 2011 transaction activity:

- The 193 sales over $10 million were dominated by major full service assets in the top ten US markets and strongly cash flowing quality select service/extended-stay products throughout the U.S.
- The number of hotels selling for over $300,000 per room almost doubled, from 22 in 2010 to 40 in 2011. These sales, which comprised 20% of transactions for the year, reflect the strength of asset values in the major metropolitan markets.
- Sales of full service hotels in suburban and secondary and tertiary markets were limited due to greater risk of NOI recovery and an inability, in many cases, to justify brand investment in brand product improvement requirements.
- Resort hotel sales were sparse, given the uncertainty of the future performance of these assets due to the slow recovery of group demand and volatile economic conditions which could impact discretionary leisure travel.
- The leasehold interest in the 1625-room Hyatt Manchester Grand Hotel was purchased by HOST for $570 million, which we believe is the highest price ever paid for a single asset, non-gaming hotel planned for continued hotel use.
- The HVS list of major hotel transactions list does not include large hotel portfolio sales where individual asset prices cannot be identified. While portfolio activity remains relatively muted by historic standards, two significant portfolios did transact, including the Innkeepers sale of 64 primarily extended-stay properties to Cerberus and Chatham Lodging for approximately $1.0 billion, and LodgeWorks sale of 24 extended-stay hotels to Hyatt for $802 million.
- Sales of smaller owner/operated hotels, generally not reflected in the $10 million major hotel transaction list, were strong due to the availability of SBA financing and improving property performance.

The top ten markets in terms of the dollar volume of sales activity, set forth below, accounted for 73% of total transaction volume in 2011.

TEN MOST ACTIVE MARKETS FOR MAJOR SALES TRANSACTIONS IN 2011

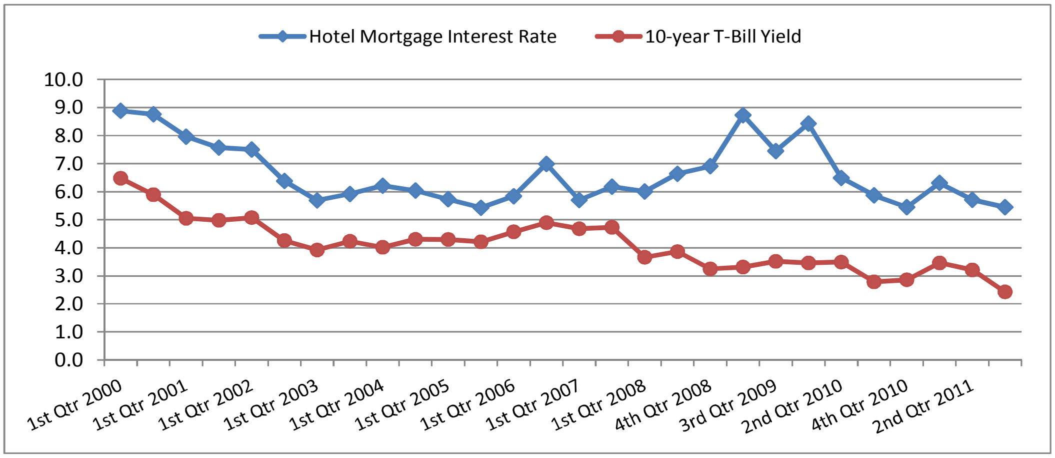
Market	$ Volume (Millions)	$/Room	No. Properties
NYC Metro	2,700.00	417,000	16
San Diego	1,700.00	279,000	18
DC Metro	700.00	296,000	10
SF Metro	700.00	231,000	16
LA Metro	600.00	228,000	10
So. Fla.	500.00	237,000	12
Chicago	400.00	232,000	4
Hawaii	200.00	149,000	3
Boston	100.00	381,000	1
Dallas	100.00	104,000	4
Source: HVS			

The New York metro area topped the list for the greatest sales volume, while San Diego experienced the greatest number of major asset sales. Both these markets are attractive to investors given their rapid recovery from the recent recession, high barriers to entry and well diversified lodging demand. Other metro areas which benefit from these same characteristics experienced significant major hotel sales transaction activity as well.

Financing Options Improving

Financing for hotel investments is improving following the stall in the fall of 2011, albeit, at more stringent terms and higher debt yields than were available during the first half of 2011. Some lenders that aggressively pursued hotel financing when there was no way for hotel NOI to go but up, decided to pull back from the market once future hotel NOI trends became more uncertain. A wider variety of lenders are now re-entering the market, and CMBS activity has resumed, albeit still at a moderate level. While the yield on the ten year T-bill is at record lows, spreads on hotel mortgages have risen, reflecting the perception of higher risk.

HOTEL MORTGAGE INTEREST RATES AND 10-TEAR T-BILL YIELDS



Source: ACLI

Debt yields have also increased to the 11% to 14% range. Nonetheless, the cost of debt remains favorable and continues to put downward pressure on capitalization and discount rates.

Profile of Buyers and Sellers Likely to Shift During 2012

REIT acquisition activity dominated the major hotel transactions market in the first half of 2011, but stalled in the fall of 2011 due to the significant decline in REIT stock prices caused by market uncertainty. As of the current date, REIT share prices have experienced a recovery, but are still trading below the levels that supported the aggressive acquisitions in 2010 and early 2011. As a result REITS are expected to be more cautious about acquisitions over the near term, particularly given the political and economic factors that might negatively impact their stock prices at any moment. Private equity funds see a window of opportunity for better pricing of acquisitions in 2012 as the REITS reduce their activity over the near term. Foreign investors, primarily from the Pacific Rim, will continue to look for buying opportunities. Owner/operators of smaller assets remain largely unfettered by the larger global economic picture and will continue to actively pursue acquisitions.

Hotel owners and developers looking to exit their investments at the top dollars witnessed in 2011 will likely refrain from putting their assets on the market, as the current cloud of political and economic uncertainty places downwards pressure on prices. REITS and private equity funds are expected to selectivity prune their portfolios over the course of 2012, while special servicers, facing the three year window for holding an asset, are likely to become more active sellers. Given the many hotels that will be facing loan maturities this year, we anticipate a spike in refinancing activity, as well as more loan workouts, extensions and foreclosures. Hotels owners that cannot justify the cost of brand mandated capital projects will be forced to place their properties on the market.

Capitalization Rates Trending Up

Rates of return, derived from actual sales transactions, are starting to trend up once again. After a rise in rates in 2009 due to the financial crisis and recession, capitalization rates markedly declined as buyers acquired properties with depressed income levels, betting on significant NOI recovery going forward. With the major rebound in NOI already behind us, and the future clouded in uncertainty, capitalization rates are starting to rise. Brokers indicate that the bid/ask gap between buyers and sellers has once again widened, due to different perceptions of the risk of future hotel earnings.

DERIVED CAPITALIZATION AND DISCOUNT RATES

	Cap Rate based on Historical NOI	Cap Rate based on 1st Yr. Projected NOI	Free and Clear Discount Rate	Equity Yield
2011	5.8	6.9	11.4	16.3
2010	4.2	5.2	11.2	15.2
2009	8.7	6.5	11.8	14.1
2008	7.1	7.2	11.2	18.2
2007	7.0	8.1	11.1	20.4
2006	6.1	7.3	10.9	19.3
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
Source: HVS - San Francisco				

The moderate rise in capitalization rates for full service and limited service hotels from 2010 to 2011 is evidenced in the following chart. Capitalization rates for select and extended-stay products actually declined 110 basis points, due to aggressive acquisition of these products by REITS, as well as the high quality of the assets that sold.

CAPITALIZATION RATES BY PRODUCT TYPE

	2011		2010	
Property Type	Average (%)	Range (%)	Average (%)	Range (%)
Full Service	5.6	1.7 - 10.9	5.3	1.7 - 8.0
Select and Extended-Stay	6.7	3.2 - 12.6	7.8	3.1 - 12.4
Limited Service	9.4	.20 - 30.0	8.5	1.3 - 16.3
Source: HVS				

Loan maturities and investment in brand mandated property improvement projects are expected to stimulate more sales of underperforming hotels in 2012, particularly in secondary and tertiary markets. A shift in the profile of hotels that transact, from the high performing assets in the top ten urban markets which dominated in 2011, to more challenged properties in 2012, may also cause cap rates to rise.

Outlook

Hotel sales transaction activity in 2012 is expected to be active, but more subdued than during the first half of 2011, due to on-going political and economic uncertainty. Significant capital has lined up to purchase assets; though the increased bid/ask spread will continue to dampen transactions until there is greater market clarity. Active market participants expect transaction activity to strengthen as the year progresses, barring any unforeseen events, as the economy continues to improve. However, resumption of a robust transaction market may have to wait until after the 2012 Presidential election. Capitalization rates are expected to continue to rise, in tandem with the recovery in lodging performance.

About HVS

HVS is the world's leading consulting and services organization focused on the hotel, restaurant, shared ownership, gaming, and leisure industries. Established in 1980, the company performs more than 2,000 assignments per year for virtually every major industry participant. HVS principals are regarded as the leading professionals in their respective regions of the globe. Through a worldwide network of 30 offices staffed by 400 seasoned industry professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. For further information regarding our expertise and specifics about our services, please visit **www.hvs.com**.

About the Author

Suzanne R. Mellen is the Senior Managing Director of the San Francisco and Las Vegas offices of HVS, heading the Consulting & Valuation and Gaming Services divisions. She has been evaluating hotels and associated real estate for 32 years, has authored numerous articles, and is a frequent lecturer and expert witness on the valuation of hotels and related issues. Ms. Mellen has a BS degree in Hotel Administration from Cornell University and holds the following designations: MAI (Appraisal Institute), CRE (Counselor of Real Estate), ISHC (International Society of Hospitality Consultants) and FRICS (Fellow of the Royal Institution of Chartered Surveyors).

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