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Washington, DC: The Ideal Hotel Market

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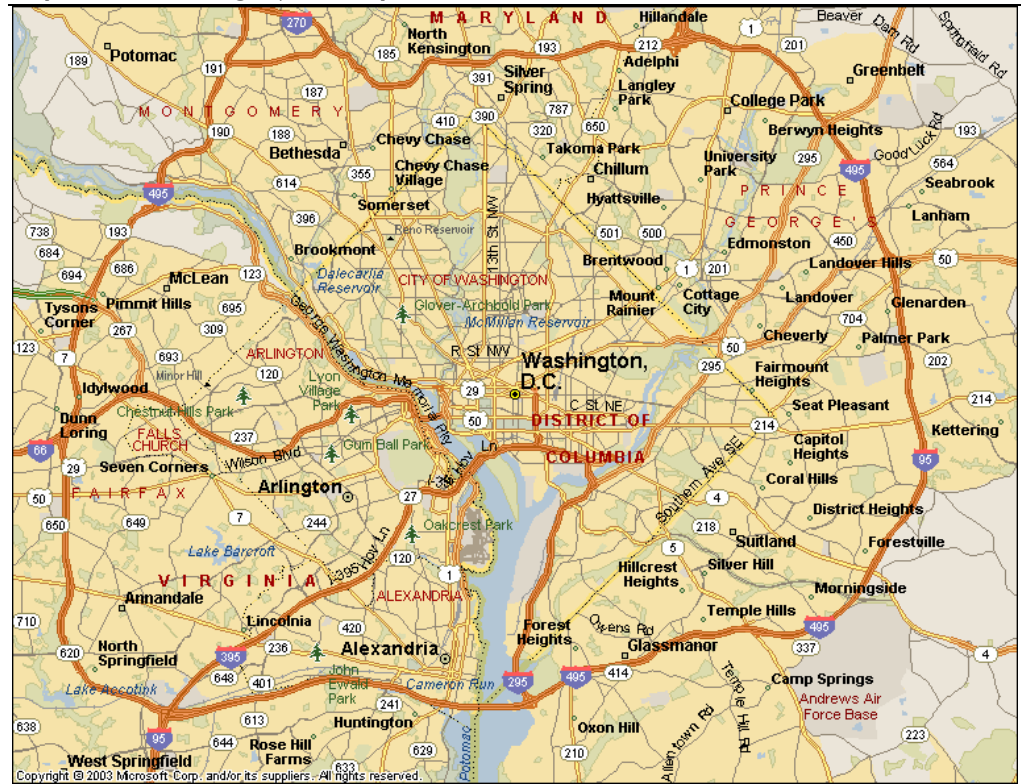
Hotel markets across the nation are largely affected by economic cycles. The Washington, DC hotel market, however, is unlike any other market across the nation, due to this city's status as our nation's capital. Washington, DC benefits from various demand generators, which encompass all market segments, allowing for a consistent level of base demand in the market. The city houses a mixture of private companies, government offices, national monuments, and museums, as well as a support infrastructure including shopping, dining, and entertainment. A multitude of factors have contributed to the Washington, DC hotel market's resiliency to economic cycles, specifically, its rapid rebound following the events of September 11. Although the local economy was obviously negatively affected by September 11, the government presence in the area appears to have been the balancing element that helped stabilize this particular market compared to other markets across the nation. This article explores the factors that have contributed to Washington, DC's historically strong hotel performance, and compares the performance of the DC hotel market to that of selected top major metropolitan markets across the United States over the past five years.

Washington, DC Overview

Located on the border of Maryland and Virginia, and measuring almost seven miles along each boundary line, the District of Columbia is a highly developed urban center. As the nation's capital, Washington is the hub for activities pertaining to domestic and international political affairs. The city houses the headquarters of the legislative, judicial, and executive branches of the federal government, and is a national focal point for associations, foreign embassies, students, tourists, and industrial groups dealing with military and government employees from all 50 states.

The greater Washington, DC metropolitan area is well served by an extensive highway network, a subway system, Amtrak, and three airports, making the area easily accessible. Amtrak, the nation's primary rail system, is based in Washington, DC and provides access to the District of Columbia's Union Station from points throughout the United States. All major commercial airlines serve the airport facilities in the Washington, DC area; U.S. Airways has a major hub at Ronald Reagan Washington National Airport, while United Airlines is the major carrier with a hub at Washington Dulles International Airport.

Map of Greater Washington, DC Metropolitan Area



Washington, DC is divided into four quadrants: Northeast, Northwest, Southeast, and Southwest, with the U.S. Capitol at the center. The Northwest quadrant of Washington, DC is generally considered the commercial district of the city. Washington, DC's Northeast neighborhood is home to a large number of Catholic institutions, including The Catholic University of America and Trinity University, as well as the headquarters of the United States Conference of Catholic Bishops. DC's Southeast neighborhood is currently in a revitalization stage, while the Southwest neighborhood is largely residential, with a mixture of retail and commercial properties.

Several of the city's neighborhoods have been developed as centers of tourist, economic, and governmental activity, including the Federal Triangle, the National Mall and Tidal Basin, Georgetown and the Northwest, Embassy Row, the Pentagon, the Arlington Cemetery area, and Capitol Hill. Area lodging facilities benefit from mid-week corporate demand, as well as leisure (primarily weekend) demand derived from the multiple museums, monuments, and attractions in Washington, DC.

In addition to being a political and economic hub, Washington, DC, is well known for its institutions of higher learning, visitor attractions, and cultural offerings. Some of these attractions include Georgetown University, the

John F. Kennedy Center for the Performing Arts, the Smithsonian Institution, the Vietnam Memorial, the Capitol, the Supreme Court, the White House, and the presidential monuments.

Virtually all of the offices, organizations, educational institutions, visitor attractions, military establishments, and governmental administrations in Washington, DC, have one common attribute: they are major generators of visitation. The District of Columbia is visited by tourists, political leaders, convention attendees, businesspeople, students, foreign emissaries, and government workers from throughout the world. As a result, the city is expected to remain an attractive market to hotel owners, investors, and operators.

**Washington, DC Post
September 11, 2001**

The terrorist attacks of September 11, 2001 had devastating effects for the nation as a whole. Specifically, New York City and Washington, DC were the two target cities during the attacks, causing an instant halt to visitation to both cities. The prolonged closing of the DC area airports, as well as the general feeling for one's personal safety following the events, caused normally strong tourism to fall off dramatically in Washington, DC.

In addition to the direct attack on the Pentagon, which caused a portion of the building to collapse, Washington, DC suffered additional turmoil such as the anthrax scares, following September 11. Anthrax-laced letters were mailed to news organizations and the Capitol Hill offices of Senate Majority Leader Tom Daschle and Senator Patrick J. Leahy, instigating a laborious search by the FBI for the source. The deaths and sicknesses that arose from the anthrax incidents instilled more fear and caution among both U.S. and international travelers.

As Washington, DC struggled to return to normalcy, it was once again plagued by negative publicity surrounding the DC-area sniper attacks during October of 2002. As random shootings occurred in the greater metropolitan area, including Maryland, Virginia, and Washington, DC, both residents and visitors alike were frozen with fear and unable to freely enjoy and explore the sights and attractions in the area. Washington, DC's bus tour visitation was especially devastated, as parents refused to allow their children to visit the nation's capital out of fear for their safety.

**What Helped
Washington, DC Survive?**

Although multiple negative events affected tourism and hotel demand to the Washington, DC area over the past few years, the city held steady and rebounded quicker than most other major metropolitan markets across the nation. The city's positive performance was assisted by a variety of factors and events.

- The 2000 presidential election was prolonged due to an unprecedented dispute over electoral votes in Florida. The uncertainty surrounding this event prolonged the presidential race, as well as the preparation required for a change in presidency and party in the White House, which led to a temporary increase in hotel demand in Washington, DC.
- In mid-2001, Vermont Senator Jim Jeffords changed party affiliation, from Republican to Independent. This change in party affiliation was the most significant political development of the newly appointed Bush Administration. The defection of Senator Jeffords from the Republican Party shifted the balance of power in the Senate from 50 Democrats and 50 Republicans, to 50 Democrats, 49 Republicans and a single Independent, giving control of the Senate and each committee to the Democrats. This event, in turn, caused an influx of lobbyists to return once again to Washington, DC, filling hotel rooms.
- Following the events of September 11, 2001, major steps were taken to improve homeland security, and government spending on federal training programs increased, initiating additional government-related demand to the area. The National Strategy for Homeland Security and the Homeland Security Act of 2002 were created to mobilize and organize the nation in order to secure the U.S. from future terrorist attacks. The addition of this organization to the Washington, DC area caused an increase in visitation to the Pentagon and other defense-related organizations, attracting independent consultants and engineers.
- In October of 2001, the government per-diem rate in Washington, DC increased from \$119.00, which it had been for several years, to \$150.00. In 2004, the per-diem rate was temporarily lowered to \$143.00, but was subsequently increased to its current level of \$153.00. The increase in the per-diem rate especially impacted the Washington, DC market, due to the increase in government travel post-September 11, and is most notable because the high rate has been sustained to the present day. Also, the per-diem rate increase changed the dynamics of the hotel market because previously undesirable, lower-rated government demand instantly became a desirable, moderately rated base demand. Modified full-service and limited-service lodging facilities suddenly found themselves competing with full-service hotels for government demand.

- Following the events of September 11, both Northern Virginia airports suffered decreased passenger counts and reduced flights. In fact, Reagan National Airport was shut down for the longest duration after the events than any other airport in the country due to its proximity to the White House and other government buildings. In April of 2002, Ronald Reagan National Airport returned to full operational status for the first time since the terrorist attacks. Despite the negative impact of September 11 on national air travel, Dulles, National, and the Baltimore-Washington International Airport (BWI, in Maryland, north of the District) have been the beneficiaries of over \$1 billion invested in new facilities in recent years. At Dulles, a new \$150-million midfield concourse was completed in early 1999; this concourse is part of a \$1.2-billion, long-term expansion plan that will involve the construction of 150 new gates and an underground light-rail system by 2010. In 1997, BWI opened a six-gate, \$110-million international arrivals building designed to boost its international traffic. The following table details the two northern Virginia airports' historical passenger traffic counts since 1994, and illustrates the significant, double-digit growth in passenger traffic that has recently occurred.

Table 1 Airport Statistics

Year	Ronald Reagan Washington National Airport			Washington Dulles International Airport		
	Passenger Traffic	Percent Change*	Percent Change**	Passenger Traffic	Percent Change*	Percent Change**
1994	15,700,825	—	—	11,690,786	—	—
1995	15,506,244	(1.2) %	(1.2) %	12,443,657	6.4 %	6.4 %
1996	15,226,500	(1.8)	(1.5)	12,894,028	3.6	5.0
1997	15,907,006	4.5	0.4	13,757,861	6.7	5.6
1998	15,970,306	0.4	0.4	15,746,342	14.5	7.7
1999	15,185,348	(4.9)	(0.7)	19,797,329	25.7	11.1
2000	15,888,199	4.6	0.2	20,104,693	1.6	9.5
2001	13,265,387	(16.5)	(2.4)	18,002,319	(10.5)	6.4
2002	12,881,601	(2.9)	(2.4)	17,235,163	(4.3)	5.0
2003	14,223,123	10.4	(1.1)	16,950,381	(1.7)	4.2
2004	15,943,859	12.1	0.2	22,872,064	34.9	6.9
Year-to-date through February						
2004	2,171,383	—	—	2,546,764	—	—
2005	2,396,719	10.4 %	—	3,908,208	53.5 %	—

* Average annual compounded change from the previous year

** Average annual compounded change from 1994

Source: Metropolitan Washington Airports Authority

- Convention activity has historically served, and will continue to serve, as a primary force in the Washington, DC lodging market. As the nation's capital, Washington, DC is a logical destination for conventions, particularly as over half of the national associations are headquartered in the DC area. In April of 2003, the new Washington, DC Convention Center opened at Mt. Vernon Square with ±2.3 million square feet of space; this facility offers ±700,000 square feet of exhibit space, ±125,000 square feet of meeting space, and ±44,000 square feet of retail space. The former Washington Convention Center, located roughly two blocks south of the new facility, offered roughly ±381,000 square feet of exhibition space and ±50,000 square feet of meeting space, and was too small and dated to support significant convention activity. The opening of the new convention center, which is both larger and built to modern standards, has resulted in a significant increase in convention activity.
- Despite the temporary slump in visitation, tourism continued to represent a key component of Washington, DC's economy and local lodging demand. The city is a major national and international tourist destination offering a wide variety of historical and cultural attractions including the Smithsonian Institution, the White House, the presidential monuments, the Vietnam Veterans Memorial, the Holocaust Memorial, and the National Mall. Recently opened tourist attractions include the International Spy Museum, which opened in July of 2002; the World War II Memorial, which opened in May of 2004; and the National Museum of the American Indian, which opened in September of 2004. Sports and entertainment venues, including the Jack Kent Cooke Stadium (NFL) and the MCI Center (NBA and NHL), are also major drivers of local leisure demand. Washington, DC's annual Cherry Blossom Festival serves as a major attraction as well, traditionally selling out hotel rooms in the greater metropolitan area.
- In June of 2004, President Ronald Reagan's passing and subsequent memorial services in Washington, DC caused a surge in hotel demand in both the city and the surrounding suburbs. Most hotels in the area were reportedly sold out for days.
- In September of 2004, Major League Baseball announced that the Montreal Expos would move to Washington, DC for the 2005 season. This marked the first time since the end of the 1971 season that the city has housed a Major League Baseball team. The first

home game, which was played at Robert F. Kennedy Stadium, was reportedly attended by a sell out crowd of 45,596 fans.

- The greater Washington, DC metropolitan area is also home to a multitude of Fortune 500 companies, which provide local hotels with a consistent level of transient commercial demand. The following table presents the Fortune 500 companies that have established headquarters in the metropolitan Washington, DC region.

Table 2 Fortune 500 Headquarters in Metropolitan Washington, DC

Rank	Company	Location
16	Fannie Mae	Washington, DC
32	Freddie Mac	McLean, VA
56	Lockheed Martin	Bethesda, MD
137	General Dynamics	Falls Church, VA
175	Marriott International	Bethesda, MD
181	AES	Arlington, VA
191	Capital One Financial	Falls Church, VA
216	Nextel Communications	Reston, VA
262	U.S. Airways Group	Arlington, VA
275	Garnett	Fairfax, VA
357	Danaher	Washington, DC
377	Pepco Holdings	Washington, DC
434	Host Marriott	Bethesda, MD
439	Coventry Health Care	Bethesda, MD
473	SLM Holding	Reston, VA
482	NVR	McLean, VA

Source: Fortune (2004) / Greater Washington Initiative

Effects of Strong Hotel Demand

The flurry of activity in Washington, DC is causing additional development and revitalization in the city, with aspirations of increasing already strong hotel performance. All aspects of the city are being addressed, including hotel development/revitalization, entertainment, attractions, and residential uses.

Several new lodging facilities are currently proposed or under development, or have recently opened in Washington, DC. These include the 400-room Mandarin Oriental that opened in March of 2004, located at 1330 Maryland Avenue, SW; the 383-room Embassy Suites, currently under construction at 1150 K Street, NW; and the 288-room Hampton Inn, which recently opened at 6th Street and Massachusetts Avenue, NW. Additionally, a proposed ±1,200-room Convention Center Marriott Hotel is planned, but is not scheduled to open until 2008.

Due to the lack of available land within Washington, DC, many developers have recently sought to redevelop existing hotels. This adaptive reuse is best illustrated by Kimpton Hotels' recently established strong presence in the market. Kimpton, which currently owns and operates six hotels within Washington, DC, purchased the Radisson Barcelo Hotel, located at 2121 P Street, NW, in November of 2004. Kimpton currently has plans to renovate and reposition the hotel to a full-service, four-star hotel consistent with its current portfolio. The newly renovated and repositioned hotel is scheduled for completion by April of 2006.

The new convention center announced in December of 2004, after just over one year of operation, that it had plans for further expansion. Already the equivalent of six football fields, the Washington Convention Center Authority approved a plan to add roughly 75,000 square feet. Although plans have not yet been finalized on the expansion, this decision clearly reflects the popularity of the new facility. The location of the former convention center is currently proposed for the development of a mixed-use project (residential, retail, and possibly a hotel).

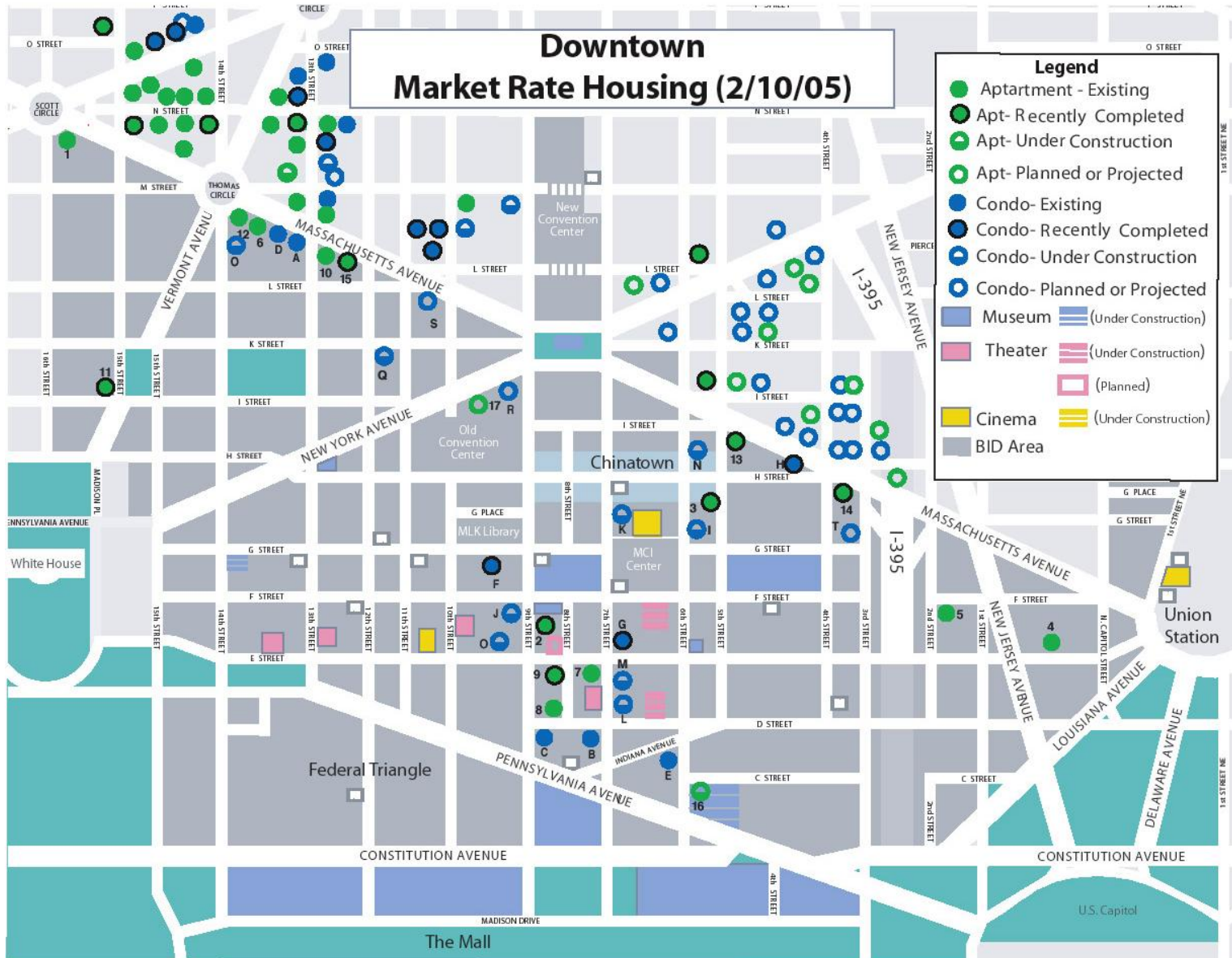
New tourist attractions on the horizon for Washington, DC include a new U.S. Capitol Visitors Center scheduled for 2005, the National Portrait Gallery and the Newseum scheduled for 2006, and the Martin Luther King Memorial scheduled for 2008. The opening of these attractions will likely be followed by increased leisure visitation to the DC area, as has historically been the case with the introduction of new attractions to the city.

A new \$535-million stadium for Major League Baseball's Washington Nationals has been proposed in the Southeast quadrant of the city, one block from the Anacostia River, with completion scheduled for 2008. The riverbank is scheduled to be developed with numerous parks, a nature center, and walking trails along with a retail marketplace. Reportedly, this is the first time that Washington has begun to develop its waterfront to serve both the local and tourist community. An aboveground metro line is also slated to provide public transportation to the area. The current plans for this particular neighborhood are intended to spark further economic development in a generally neglected portion of the city.

Further transformation of the Northwest (Downtown) neighborhood of Washington, DC is expected, primarily as a result of residential redevelopment interest in Downtown. By the end of 2005, the population of the Downtown area is projected to be roundly 5,600, representing an increase of ±115% over the 2000 population. By the end of 2010, population in the Downtown area is projected to be approximately 7,200. Due to the fully developed nature of DC's Northwest neighborhood, the majority of

residential development is planned to occur east of the new convention center, in an area called the Mount Vernon Triangle. Approximately 3,500 to 4,500 housing units and ±2.0 million square feet of commercial developments are planned for this neighborhood. A map indicating these projects, as provided by the Downtown Business Improvement District, is presented on the following page.

Downtown Washington, DC Residential Developments



Overview of Top Metropolitan Markets

Washington, DC's steady performance during the recent economic recession, in comparison to other major metropolitan markets across the nation, illustrates the benefits of its diverse economic base. The following tables illustrate the occupancy, average rate, and RevPAR trends of ten top major U.S. metropolitan markets from 2000 through 2004, as recorded by Smith Travel Research.

Table 3 Top Metropolitan Markets – Occupancy Percentage, 2000 through 2004

Metropolitan Area	2000	2001	2002	2003	2004	Ave. Annual Compounded Change 2000-2002	Ave. Annual Compounded Change 2000-2004
Atlanta, GA	65.9 %	60.9 %	57.7 %	56.2 %	58.7 %	(6.4) %	(2.9) %
Boston, MA	75.7	64.5	63.3	60.4	64.2	(8.6)	(4.0)
Chicago, IL	70.6	62.1	59.3	60.6	62.0	(8.4)	(3.2)
Houston, TX	62.5	64.7	59.5	56.4	56.2	(2.4)	(2.6)
Los Angeles - Long Beach, CA	72.7	66.8	65.8	67.4	71.6	(4.9)	(0.4)
New York, NY	83.3	73.6	73.7	74.7	81.1	(5.9)	(0.7)
Philadelphia, PA	65.5	62.9	64.6	64.8	68.0	(0.7)	0.9
Phoenix, AZ	62.6	58.7	57.7	59.7	63.6	(4.0)	0.4
San Francisco - San Mateo, CA	80.9	64.7	61.3	62.6	68.0	(13.0)	(4.2)
Washington, DC-MD-VA	73.3	66.7	65.5	66.5	70.6	(5.5)	(0.9)

Source: Smith Travel Research, STR Lodging Review

Table 4 Top Metropolitan Markets – Average Rate, 2000 through 2004

Metropolitan Area	2000	2001	2002	2003	2004	Ave. Annual Compounded Change 2000-2002	Ave. Annual Compounded Change 2000-2004
Atlanta, GA	\$ 80.09	\$ 79.30	\$ 76.54	\$ 74.03	\$ 76.18	(2.2) %	(1.2) %
Boston, MA	145.00	136.21	123.34	117.04	124.01	(7.8)	(3.8)
Chicago, IL	116.42	113.12	103.39	102.21	102.57	(5.8)	(3.1)
Houston, TX	74.96	75.65	74.37	72.77	76.05	(0.4)	0.4
Los Angeles - Long Beach, CA	97.95	95.54	91.54	91.10	96.05	(3.3)	(0.5)
New York, NY	205.82	182.99	174.13	169.27	186.09	(8.0)	(2.5)
Philadelphia, PA	101.89	98.26	96.49	93.30	95.68	(2.7)	(1.6)
Phoenix, AZ	100.61	100.18	93.48	94.12	97.42	(3.6)	(0.8)
San Francisco - San Mateo, CA	149.56	143.73	123.04	116.92	117.96	(9.3)	(5.8)
Washington, DC-MD-VA	116.24	116.89	110.59	110.92	118.59	(2.5)	0.5

Source: Smith Travel Research, STR Lodging Review

Table 5 Top Metropolitan Markets – RevPAR, 2000 through 2004

Metropolitan Market	2000	2001	2002	2003	2004	Ave. Annual Compounded Change 2000-2002	Ave. Annual Compounded Change 2000-2004
Atlanta, GA	\$ 52.78	\$ 48.29	\$ 44.16	\$ 41.60	\$ 44.72	(8.5)	% (4.1)
Boston, MA	109.77	87.86	78.07	70.69	79.61	(15.7)	(7.7)
Chicago, IL	82.19	70.25	61.31	61.94	63.59	(13.6)	(6.2)
Houston, TX	46.85	48.95	44.25	41.04	42.74	(2.8)	(2.3)
Los Angeles - Long Beach, CA	71.21	63.82	60.23	61.40	68.77	(8.0)	(0.9)
New York, NY	171.45	134.68	128.33	126.44	150.92	(13.5)	(3.1)
Philadelphia, PA	66.74	61.81	62.33	60.46	65.06	(3.4)	(0.6)
Phoenix, AZ	62.98	58.81	53.94	56.19	61.96	(7.5)	(0.4)
San Francisco - San Mateo, CA	120.99	92.99	75.42	73.19	80.21	(21.0)	(9.8)
Washington, DC-MD-VA	85.20	77.97	72.44	73.76	83.72	(7.8)	(0.4)

Source: Smith Travel Research, STRLodging Review

Based on the Smith Travel Research data, New York, San Francisco - San Mateo, Boston, and Washington, DC-MD-VA led the nation in terms of overall RevPAR in 2000, during the “golden days” of the hotel industry. Early 2001 marked the beginning of the economic recession, which was further exacerbated by the events of September 11. The attacks on the nation greatly affected both domestic and international travel to the United States.

Occupancy levels across the board began experiencing losses in 2001. This negative trend continued into the following year. In 2003, most of the major metropolitan markets across the nation began to stabilize, with some cities beginning to realize gains in occupancy for the first time since 2000. On an average annual compounded basis from 2000 through 2004, two markets realized occupancy gains (Philadelphia and Phoenix), while the remaining markets suffered losses. The Washington, DC market recorded one of the least dramatic occupancy losses among the markets examined. In terms of average rate, Washington, DC was one of two markets that actually recorded growth on an average annual compounded basis from 2000 through 2004, boasting the largest growth, at 0.5%.

As evidenced by the dramatic losses suffered from 2000 through 2002, which was when the majority of the downturn occurred, many major cities recorded double digit RevPAR losses on an average annual compounded basis, including San Francisco - San Mateo, Boston, Chicago, and New York. Although Washington, DC also recorded losses during this two-year period, the declines were significantly less dramatic than the majority of the major metropolitan markets examined. The average annual compounded RevPAR decreases recorded during the period from 2000 through 2004 further illustrate Washington, DC’s stability, with a mere 0.4% decline,

which is the least dramatic loss (accompanied by the Phoenix hotel market) when compared to the other major metropolitan markets. The Washington, DC market improved its ranking among major metropolitan hotel markets nationwide, moving from the fourth-highest RevPAR level in the nation in 2000, to the second-highest RevPAR level in 2004, just behind New York.

The following table illustrates an even more compelling argument in favor of the Washington, DC hotel market. Savvy hotel investors generally seek to invest in markets that possess a combination of low volatility and large increases in value. The following table shows the ranking of markets with low volatility, illustrating the top nine markets, and the nation as a whole, which possess the highest per-room value increases, ranked firstly on a percentage change basis and secondly on a dollar basis. As presented in the table, Washington, DC ranked third in terms of percentage increases and second in terms of dollar increases, based on forecasts for the period from 2004 through 2006, thus making it an attractive investment market. On a per-room dollar basis, Washington, DC is surpassed only by Oahu, which logically has higher barriers to entry and more difficult development processes than Washington, DC. This information is based on the 2005 Hotel Valuation Index, which is prepared annually by HVS International.

Table 6 Markets with Low Volatility and Large Increases in Value

Rank	Index of Volatility		Percent Change 2004-2006	Rank	Index of Volatility		Per Room Change 2004-2006
1	21%	Portland, OR	76%	1	18%	Oahu, HI	\$66,000
2	21%	Orlando, FL	50%	2	21%	Washington, DC	\$41,000
3	21%	Washington, DC	42%	3	20%	Miami, FL	\$35,000
4	21%	Tampa, FL	41%	4	21%	Orlando, FL	\$33,000
5	21%	Minneapolis, MN	39%	5	14%	Las Vegas, NV	\$30,000
6	20%	Miami, FL	37%	6	19%	USA	\$18,000
7	19%	USA	33%	7	21%	Tampa, FL	\$17,000
8	23%	Cincinnati, OH	33%	8	25%	Anaheim, CA	\$15,000
9	18%	Oahu, HI	32%	9	21%	Minneapolis, MN	\$13,000
10	20%	Memphis, TN	30%	10	18%	Baltimore, MD	\$11,000

Source: HVS International

Conclusion

The multitude of positive attributes found in the District, in conjunction with a push for new development and the adaptive reuse of functionally obsolete buildings, are expected to serve to keep the hotels in the area performing at historically high levels moving forward. Washington, DC benefits from a consistent level of base hotel demand, with a strong government presence, and is further assisted by isolated and recurring events that sell out hotels in the area, including the presidential election and

subsequent inauguration and the annual Cherry Blossom Festival. The greater Washington, DC metropolitan area benefits from an extensive highway network, a subway system, Amtrak, and three airports, making the location readily accessible for both business and leisure travelers.

Economic cycles are inevitable and will come and go, causing ups and downs in every hotel market. However, the current and planned infrastructure in Washington, DC, as well as its status as our nation's capital, should continue to make the District one of the most attractive and least volatile hotel markets in the United States.