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HOTEL yearbook 2012

Scenarios for the year ahead

A special excerpt from
the Hotel Yearbook 2012:

The 2012 outlook for key geographic markets
Exclusive situation reports from Horwath HTL

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The Ecole hôtelière de Lausanne (EHL) is the co-publisher of The Hotel Yearbook. As the oldest Hotel School in the world, EHL provides university education to students with talent and ambition, who are aiming for careers at the forefront of the international hospitality industry. Dedicated to preparing tomorrow's executives to the highest possible level, EHL regularly adapts the contents of its three academic programs to reflect the latest technologies and trends in the marketplace. Since its founding in 1893, the Ecole hôtelière de Lausanne has developed more than 25'000 executives for the hospitality industry, providing it today with an invaluable network of contacts for all the members of the EHL community. Some 1'800 students from over 90 different countries are currently enjoying the unique and enriching environment of the Ecole hôtelière de Lausanne.

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Fundamentals rebounding

OUR REGIONAL OUTLOOK CONTINUES WITH A LOOK AT KEY MARKETS IN THE WESTERN HEMISPHERE. **HORWATH HTL** HAS PROVIDED AN IN-DEPTH LOOK AT THE PROSPECTS FOR 2012 IN THE USA, BRAZIL AND THE CARIBBEAN.

USA

SITUATION REPORT

Economy

The economy of the United States is the world's largest national economy. Its nominal GDP was estimated to be nearly $14.7 trillion in 2010, approximately a quarter of nominal global GDP. The US economy has been expanding since the end of the recession, which is officially considered to have ended in June 2009. The recovery has been fragile, however, with many mixed signals that have led to uncertainty in the consumer and business markets.

The announcement in July 2011 from the Commerce Department's Bureau of Economic Analysis that from late 2007 through the end of June 2009, the US economy contracted 5.1 %, was an upward revision from the previous figure of 4.1 %. This signaled that the recession was even worse than had been thought, and put into perspective the modest nature of the recovery. The US Bureau of Economic Analysis reports third quarter 2011 GDP growth of 2.5 % over the same quarter the prior year, with the annual growth rate measured at 1.6 %.

While the positive growth in GDP indicates that the recovery has continued for nine consecutive quarters, it has largely been a jobless recovery, with the unemployment rate hovering around 9 % for the past year.

The high unemployment rate, coupled with the lingering housing market downturn, has hit consumers hard. TransUnion, a credit reporting agency, has reported an uptick in mortgage delinquencies for the third quarter to 5.88 %, the first such increase since the fourth quarter of 2009. Furthermore, housing prices continue to erode, declining 1.1 % in September according to CoreLogic, with Fitch Ratings anticipating a further 10 % slide before the market stabilizes.

As a result of the combination of these factors, consumer confidence is near all-time lows, and given that consumer spending is a significant driver of the overall GDP, the low consumer confidence levels indicate worrisome conditions for future sustained economic growth.

Finally, both external threats and internal political gridlock further exacerbate the problems facing the country's economic recovery. For the former, the sovereign debt crisis in the Euro-zone has markets alarmed at the possibility of yet another round of bank failures or bailouts, or even the collapse of the Euro as a central currency. And internally, the country has to face significant issues related to the federal deficit, with no indication of cooperation in Congress to resolve the issues. All of these conditions threaten to stall the recovery or, worse, push it back into a double-dip recession.

Lodging industry performance

Similar to the overall economy, the US hotel industry continued its recovery in 2011 from the depths of the downturn in 2009. The overall trends featured the following : supply growth remained low ; demand grew at a steady rate ; growth in ADR occurred ; and RevPARs grew as well as overall profits.

According to Smith Travel Research (STR), through September 2011, year-to-date national occupancy was up 4.6 % (58.9 % YTD 2010 versus 61.6 % YTD 2011) while ADRs were up 3.6 % ($97.97 in 2010 and $101.45 in 2011). The result of the growth in these indices was RevPAR growth for year-to-date 2011 of 8.3 % ($57.74 in 2010 and $62.54 in 2011). The steady growth of lodging demand, coupled with ADR growth, despite the negative economic environment appeared to demonstrate the underlying momentum of the lodging market's recovery.

STR statistics indicate that the Luxury segment enjoyed the largest increase in RevPAR growth at 8.6 % year-to-date through September 2011, although all segments (Upscale, Mid-Price, Economy and Budget) had RevPARs growing at rates in excess of 7 %. In general, it appears that the US lodging recovery was being led by the RevPAR growth at the upper end of the scale in Upscale, Upper Upscale and Luxury segments.

With respect to overall location, STR reports that the Resort and Urban markets experienced the strongest RevPAR growth

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rates (10 % and 8.6 % respectively), while the Small/Metro Town locations experienced the lowest growths in RevPAR at 6.7 %. The top 25 markets are leading the way in terms of RevPAR growth at 9.6 % while all other markets had RevPAR growth at 7.3 %. Within the top 25 markets, the metro areas with the largest RevPAR growth in 2011 included San Francisco/San Mateo (19.5 %), Nashville (13.6 %) Oahu Island-Honolulu (13.5 %), Dallas (13.3%), Los Angeles-Long Beach (13.3 %) and Miami-Hialeah at (13 %). The top 25 markets with the lowest RevPAR growth included Washington DC-Maryland-Virginia (0.9 %), Norfolk/Virginia Beach (2.3%) and St. Louis (5.2 %). New York and Chicago experienced RevPAR growth of 6 % and 8.9 % respectively in 2011.

Most industry experts are anticipating year-end 2011 RevPAR's growth to be in excess of 7 % when compared to 2010, with similar type growth rates forecast for 2012. RevPAR growth in excess of 5 % has traditionally become regarded as exceptional. Despite this recovery, the US lodging metrics are still approximately 5 % below those of 2007, so if growth occurs as projected in 2012, the performance may finally surpass these previous high, although not adjusted for inflation.

With respect to hotel industry revenues and profits, STR reports that in 2010 industry revenues in the US were $127.7 billion with industry profits moving to $18 billion. Many experts believe that with the improving lodging metrics, which are indicating significant growth in revenue for 2011, profits, or NOI, will grow in excess of 10 % and possibly 15 % in 2012.

Supply

US Hotel rooms in the development pipeline are considered to be at very low levels. As of September 2011, according to STR, there were approximately 54,000 hotel rooms (or approximately 350 new properties) under construction, a decrease of 7.8 % from the same period in 2010. The Upper Upscale and Upscale segments represent the majority of these rooms (over 58 %). Markets experiencing the strongest number of hotel rooms under-construction are in key US cities such as New York, Boston, Orlando, Miami and Washington DC. The Pacific region experienced the largest decrease in rooms under-construction or in the active development pipeline,

The low level of new hotel construction is one of the major factors keeping markets growing in terms of their occupancy and rate. Given the lack of capital available in the market due to the uncertain economic conditions, the amount of new construction is expected to remain low for the next several years.

Transactions slowed by access to capital

What goes down, must come up. The rebound in US hotel investment went from a near-dead stop in 2009 to $14.5 billion as of the 3rd quarter of 2011, according to Real Capital Analytics. This rapid growth has also had a positive effect on average prices, which went from an average of $60,000 to about $140,000 per key, where it seems to have stabilized. This average pricing trend has been heavily influenced by pricier downtown transactions in major markets, most notably in New York City, specifically Manhattan. Coastal markets, including New York, Los Angeles, Boston, and Miami, dominated the acquisition market for hotels in the first half of 2011. Specifically, hotel sales in Manhattan totaled $1.7 billion during the first six months of 2011. San Diego, which boasted the two largest hotel deals during the first half of 2011, was close behind with a sales volume total of $1.6 billion. The third-ranked city was Los Angeles with sales volume of $499.0 million. Furthermore, urban markets such as New York, Boston, Washington DC and San Francisco are highly sought after as many hotel assets trade at below replacement cost, and these primary markets have shown the strongest market rebound. Full-service properties comprise more than 75 % of trades and account for most of the price appreciation.

The largest portfolio trade was Hyatt's $650 million acquisition of 24 assets from Lodgeworks, followed by the family of Cheng Yu-Tung (a billionaire from Hong Kong) who purchased five luxury properties from Rosewood and Maritz Wolff for $521 million, and Five Mile Capital's $400 million acquisition of a Red Roof Inns portfolio. In a multi-property sale, Hersha Hospitality Trust sold 18 hotel assets, mainly consisting of Residence Inns

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and Hampton Inns, to an affiliate of Starwood Capital Group for an aggregate purchase price of $155.0 million, or about $80,560 per key. The hotels range in size from 72 rooms to 150 rooms and are located throughout the East Coast. Hersha sold this portfolio as part of its « noncore disposition program » aimed at realigning its portfolio towards urban gateway markets with higher growth opportunities. The sale price was based on trailing 12-months income and a reported overall capitalization rate of 8.4 %. This strategy of disposition aligns with the market trends across the country, and other companies may move towards such dispositions if the major urban markets continue to demonstrate stronger performance than secondary cities.

National chains took advantage of the economic downturn to remove older product from their systems by requiring upgraded property improvement programs (PIPs). The end result for the older and/or smaller properties that have been suffering from the economic down turn is an inability to maintain their product,

> The recent turmoil in world capital markets, issues with the potential Greek economy and a volatile stock market resulted in significant declines in hotel REIT share prices

much less capitalize a PIP. Without a franchise affiliation, the impact is two-fold : declining values due to the recession plus an immediate loss in value of approximately 30 % according to brokers, from the loss of the franchise.

Brand quality and asset location remain key factors for investors. Over the past 12 months, lower prices attracted investors, leading to a 30 % increase in sales of limited-service properties affiliated with national brands. Transaction velocity was more brisk in the last six months of the period, when approximately 55 % of all deals for the entire year were executed. Activity during this period, however, does not fully reflect the effects of economic turmoil at the end of the third quarter. The median price of branded limited service properties was $27,800 per room over the past 12 months, marking a decline of 20 % from the previous 12-month stretch. The effects of distress on values remained evident, with multiple properties trading at less than $15,000 per room. While the recovery in sales of flagged limited-service properties remains notable, sales of full-service assets with brand affiliations have dominated activity through much of this year.

REITs active, but cooling off

In 2010, REITs were the largest buyer group across the Americas, accounting for 51 % of single-asset acquisitions by volume, or 40 % of the number of single-asset trades, evidencing the high quality of the assets they purchased. In particular, major hotel assets situated in gateway US markets were highly sought after by lodging-centric REITS that had the ability to raise relatively low cost capital through IPO's and offerings. The recent turmoil in world capital markets, issues with the potential Greek economy and a volatile stock market resulted in significant declines in hotel REIT share prices. These share prices of publicly traded hotel focused REIT's do not currently justify acquisition activity, and they are effectively now out of the market. According to a recent report by PwC, a more eclectic group of bidders, such as equity funds and foreign buyers, are surfacing as they, too, look for opportunities in the lodging sector as prices rise in other commercial real estate segments, such as apartments.

Financial turmoil

The question was asked at the US Hotel Appraisal 2011 Hospitality Conference : « What makes hotel financing so hard to produce or attain in this economy ? » The answer is complex. They include new FDIC regulations that set strict capital requirements for lenders, and improving but still weak hotel performance nationwide, which makes hoteliers reluctant to

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take on debt. These challenges affect not only hotel loans but hotel transactions and values. Nonperforming loans are seen by lenders as a sign that a hotel has lost value. When borrowers are « underwater » on their hotel loans, they have nowhere to go.

More assets came to market in 2011 due to several factors. First of all, lenders took control of assets and sold them as real estate owned (REO), or appointed a receiver to sell the asset or restructure the debt and arrange a consensual sale with the borrower. Secondly, asset sales increased due to the maturing debt which could not be refinanced at current loan-to-value rates (60 % to 65 %), resulting in the borrower needing to sell the asset to retire the debt. While delinquency rates for hotel CMBS loans are down slightly in October, to approximately 12.4 % as a result of resolving $604 million in troubled loans, according to Fitch, there is still over $12 billion in hotel CMBS loans maturing in 2012, which will be difficult to refinance in the current market conditions.

Capitalization rates

In the investment market, low interest rates will sustain activity, though the effects of uncertain economic conditions remain unclear. Unresolved challenges in Europe may tighten the availability of acquisition financing, which remains accessible only to the most qualified borrowers. A shift in buyer composition has also developed in the fourth quarter of 2011. REITs, that paid capitalization rates as low as 7 % for select assets in primary markets, dropped out due to a decline in stock prices in the third quarter. This has provided additional acquisition opportunities for private investors. The market for branded full-service or select-service hotels remains strong, especially for assets in primary markets or locations with strong demand drivers. Capitalization rates for these properties vary based on brand and location, but range from 9 % to 10 % for most assets. Distressed properties also remain available, usually on an all-cash basis.

With mortgage interest rates at historic lows, and plentiful equity capital (more buyers than sellers), capitalization as well as discount rates have continued to fall, as shown on the following chart.

HOSPITALITY INVESTMENT SURVEY RESULTS

	Capitalization Rates (OAR)*			Discount Rates (IRR)*		
Lodging Segment	**3rd Q 2011**	**1st Q 2011**	**3rd Q 2010**	**3rd Q 2011**	**1st Q 2011**	**3rd Q 2010**
National Economy/ Limited-Service/ Midscale	9.80%	9.80%	10.20%	11.38%	11.94%	12.31%
National Select Service	9.40%	8.40%	NAV	11.55%	11.55%	NAV
National Full-Service	7.96%	8.79%	9.50%	10.75%	10.95%	12.15%
Luxury/Upper Upscale	8.05%	8.28%	9.00%	10.56%	10.58%	11.41%

**Rates on unleveraged, all-cash transactions*

Source : PwC Real Estate Investor Survey, 3rd Quarter 2011

OUTLOOK FOR 2012

With a reluctance of banks to lend on the development of new supply of US hotel rooms for the foreseeable future, lodging fundamentals are rebounding as corporate and group meeting business continues to increase from cyclical lows. The perceived long-term upside in the lodging sector has resulted in heightened transaction activity and pricing of all types of hotel assets over the past year.

According to the 3rd Quarter 2011 PwC Real Estate Investor Survey, survey participants expect most property values to rise, on average, over the next 12 months. Expectations range up to 40 % for the Select Service segment, with the lowest average of 3.9 % for the Full Service segment.

EXPECTED VALUE CHANGE* Survey Lodging Markets

Segment	Range	Average
National Economy/Limited-Service/Midscale	(2%) to 30%	5.90%
National Select Service	0% to 40%	11.70%
National Full-Service	(10%) to 30%	3.90%
Luxury/Upper Upscale	0% to 25%	6.40%

**Over the next 12 months*

Source : PwC Real Estate Investor Survey, 3rd Quarter 2011

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There are many uncertainties in the national and global economy that could result in a return to the doldrums for both hotel market performance and the transaction levels in the country. Should the fundamental conditions of the US economy continue to gradually improve, however, these projections mean that hotel asset values will continue to improve over the near term.

| Mark Beadle

BRAZIL

SITUATION REPORT

The eyes of the world have turned to Brazil during the last years. Its outstanding economic growth, supported on solid macro-economic fundamentals that result in an improving market performance and the leadership in all the regional economic rankings (FDI, industrial production, infrastructure development), has positioned Brazil, a country accounting for 47 % of the overall area of South America, and with the 5th highest population in the world (191.5 million people), as the one of the « stars » of the selected BRIC group.

One of the major effects (and causes) of the Brazilian economic tale has to do with the widespread appearance of the middle class. Though inequality remains present in most of the regions and major cities of Brazil, the truth is that the economic policies implemented during the last decade boosted the purchasing power of millions of Brazilians, stimulating all the sectors of the

Salvador Prime Complex,
Hotel InterCity Premium Salvador,
Salvador de Bahia – Brazil

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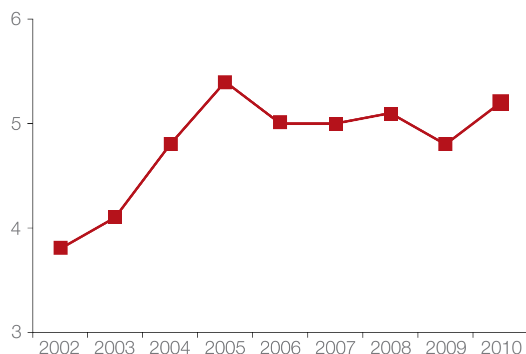
economy, including, of course, the demand for hotel, tourism and other related services.

Domestic demand rules the hotel and tourism industry. 88 % of the total tourism demand (accommodation, transport, services in general) is generated by domestic tourists. Looking at the flat trend in international tourist arrivals in Brazil over the last few years, it is clear that demand growth is not linked to the external segment.

INTERNATIONAL TOURIST ARRIVALS TO BRAZIL (MILLIONS) / 2002-2010

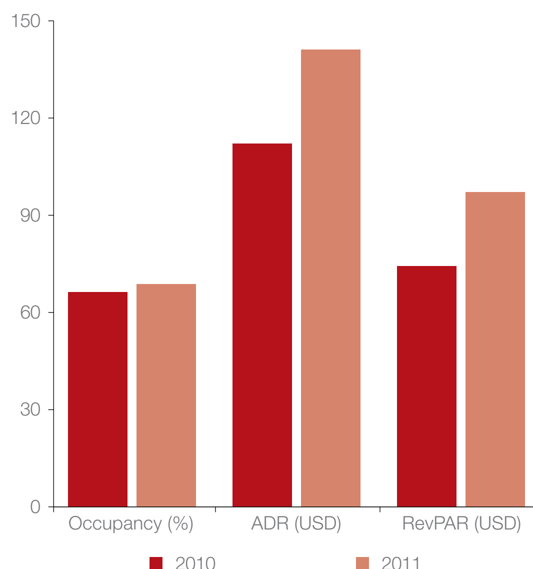


Source: Ministry of Tourism of Brazil

During 2011, the Brazilian hotel market grew significantly in comparison with 2010, mainly in the variables related to rates and RevPAR. In general terms:

- Average occupancy in the last three years has remained above 60 %, declining slightly in 2009.
- Average daily rate has posted steady growth since 2004, reaching US$ 141 in 2011 (September YTD).
- RevPAR has also increased gradually since 2004, reaching US$ 97 in 2011 (September YTD).

BRAZIL HOTEL MARKET PERFORMANCE /YEAR TO DATE – SEPTEMBER 2011 VS SEPTEMBER 2010)



Source: STR Global

Brazil's current hotel supply consists of over 9,500 hotels (over 440,000 rooms) and, though the country has become one of the most attractive hotel investment markets in the region, offering interesting long-term growth potential, as less than 10 % of the total hotel offer (27 % of total rooms) is chain affiliated, either nationally or internationally, while small and non-affiliated independent hotels account for 90 % of the total hotel offer (73 % of total rooms).

The emergence and growth of low cost and regional airlines, the development of the national infrastructure and the decentralized economic profile of the country (22 cities with more than 1 million inhabitants) ensure the basis for a growing domestic market. On the other hand, regional and national hotel chains such as Bourbon, InterCity or Slaviero became aware of this scenario and are developing a new generation of Brazilian hotel

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chains that combine local products with a more professional and standardized operation. Finally, though real estate funds are starting to appear as an attractive option to invest in the hotel industry, most of the funding for the Brazilian hotel supply under development is still gathered through other mechanisms, including widely held stock, family funds and financing through public sector programs (BNDES).

OUTLOOK FOR 2012

Brazil's hotel industry is still going through a transformation period, developing the competitiveness of the hotel supply, diversifying tourism destinations and introducing new lodging formats. Competitive supply, once linked to family and local owners, is slowly moving towards a more professional and « chain-affiliated » scenario through the penetration of international and, primarily, national hotel chains.

Taking into account the domestic profile of the Brazilian market, projected investments and scheduled openings for the next year are oriented to increase the supply of three main segments of the market :

1) *Economy and mid-scale (3 and 4-star) hotels located in secondary cities* (i.e. those with a population of 300-800,000). Frequently as part of mixed-use projects including retail, offices and/or residences, these type of products, developed as part of clusters, are turning out to be attractive due to their risk diversification and ease of commercialization among small investors (i.e. widely held stock).

2) *Upscale hotels (5-star) in capital cities.* Some major urban centers like Belo Horizonte still don´t have a developed upscale supply. International hotel chains have become aware of this and are planning future openings and seeking opportunities.

3) *Convention center hotels.* According to the last ICCA (International Congress and Convention Association) rankings, Brazil is one of the top ten countries in the world in terms of hosting international events ; moreover, the domestic market is growing exponentially. This type of product could also find opportunities in secondary markets (regional capital cities) that concentrate major industrial areas and commercial activities and lack of infrastructure to host large events.

In the coming year, we will see the consolidation of the domestic market in terms of demand, while international brands will have to prove their commercial skills against the more flexible and familiar national hotel chains, whereas foreign investors should stop setting their eyes on Brazil – and start setting their feet here !

| Mariano Carrizo

THE CARIBBEAN

SITUATION REPORT

Economies in the Caribbean in 2010 experienced a better than-expected economic recovery. The Gross Domestic Product (GDP) of the region expanded by 2.9 % in 2010, after contracting by 1.3 % in 2009. Although this was after a 6.5 % increase in 2007, economic growth is expected to slightly continue recovering by 3.1 % in 2011 and 3.4 % in 2012. Predicted total tourism and travel contribution to GDP for the Caribbean is the highest in the world at 14.2 % at the end of 2011, while the Caribbean is rated as the number 1 region out of 12 regions measuring the relevance of tourism to its national economy.

Tourist arrivals for 2010 in the Caribbean managed to recover the loss of 2009, and match the figure of 2008 with 20.1 million arrivals, compared to 19.5 million for 2009. The most visited destinations in the Caribbean are Dominican Republic, with over 4 million visitors a year, Cuba (2.3 million), the Mexican Caribbean (2.1 million) and Jamaica (1.9 million). Visitors to the Bahamas and Puerto Rico also totaled 1.3 million each. These countries make up 73 % of the total tourist arrivals, with all the other islands together accounting for the remaining 27 % of the air visitors to the Caribbean in 2010.

The market share of tourist arrivals to the Caribbean during the last decade indicate that the Caribbean has been consistently attracting a market share of the world tourist arrivals between 2 % and 3 %, giving the Caribbean the 10th highest ranking out

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of the world's top 15 regions for international tourism receipts. This performance has been consistently achieved during more than 30 years, which is a clear indication of the sustainability of the region's tourism industry.

International tourism receipts for the Caribbean region were $23.6 billion for 2010, an increase of 2.1 %, which is an improvement on the two previous years of -3.2 % and -5.3 % for 2008 and 2009 respectively. These numbers make the Caribbean region the 4th highest in the world for receipt per tourist arrival.

Our estimation of room supply in the Caribbean for the year 2010 was approximately 300,000 hotel rooms. The major destinations providing this supply are, the Dominican Republic with nearly 68,000 rooms, Cuba (50,000), the Mexican Caribbean zone (28,000), and Puerto Rico (14,000). The Organization of Eastern Caribbean States (OECS) countries comprise 18,000 rooms, the other Caribbean Commonwealth countries about 75,000, and the Dutch West Indies and French West Indies about 17,000 each. This represents a growth in the hotel room supply of 14 % in the last five years; the stock of hotel rooms in 2005 amounted to 260,000. Physical hotel plant investment in the Caribbean Region is mostly concentrated in the costal zones of each corresponding Island. The commercial hotels are mainly located in the major cities of the islands, such as Kingston (Jamaica), San Juan (Puerto Rico), Santo Domingo (Dominican Republic), and other cities.

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During the year 2010, our estimates of the average hotel occupancy in the Caribbean region was 63 %, an important indication in the beginning of recovery in the hospitality industry after the economic crisis of 2008, which led to a drop in hotel occupancy. The highest hotel occupancies reached were in Puerto Rico (73 %), Dominican Republic (67 %), US Virgin Islands (65 %) and the Mexican Caribbean (60 %). The rest of the Caribbean Countries achieved occupancy rates that range from 57 % to 62 %. The average occupancy and room rates are generally higher for the resort hotels in the coastal zones, compared to business hotels in either luxury, upper upscale, upscale or any other type of hotels.

> Most of the tourism industry believes that the BRIC economies are one of the biggest growth opportunities of the next five years – if not the biggest

The main source of market tourist arrivals to the Caribbean in 2010 was the USA, providing 50 % of all stopover arrivals. Europe was the next largest contributor to Caribbean arrivals (19 %), with Canada just behind (14 %).

OUTLOOK FOR 2012

We believe that the Caribbean will continue maintaining its fair share as one of the premier worldwide tourism destination. Its rich diversity of history, culture and language along with its range of tourist attractions, including beaches, scenery and the hospitality of its people, makes the Caribbean one of the most attractive investment destination worldwide. This view is supported by Josef Forstayr, president of the Caribbean Hotel and Tourism Association (CHTA) who states that the Caribbean « will continue to inspire our potential visitors from North America and Europe, » as the Caribbean can « recognize the opportunities which exist in new, emerging economies. » He also states that the Caribbean countries are the « masters of good value for money... necessary during times of economic stress » and is « confident » the Caribbean will remain the most « desirable warm weather destination in the northern hemisphere. »

The role of the BRIC (Brazil, Russia, India and China) countries will play an important role in future tourism trends in the Caribbean. China has the 4th most important outbound travel market, according to the WTO (World Tourism Organization), and Brazil has seen record growth in its international network in the Caribbean. St Maarten recognizes that to commit to sustainable development, it needs to develop a BRIC policy to attract the fastest developing economies. Also, most of the tourism industry believes that the BRIC economies are one of the biggest growth opportunities of the next five years – if not the biggest.

The Caribbean's traditional single-hotel developments are changing to projects based more on efficient touristic mixed-use concepts. This has led to an increased number of leisure products in the Caribbean, including golf, spa, luxury real state, conference centers, resort and vacation communities.

Tourism's contribution to the GDP has helped the Caribbean to smooth the effects of the financial crisis ; also the trends for 2012 predict an increase in the performance of the key indicators for the tourism and hotel industry in the Caribbean, including increases in occupancy, room rates and RevPAR. The rising number of tourist arrivals, market share and tourism receipts all reflect an improving industry for the region since the financial crisis. Based on the expected outlook for the region, we believe the future of the Caribbean hotel industry will be of continued improvement, reaching the prevailing performance levels prior to the crisis in a short period of time.

Sotero Peralta ■

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