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MARKET SNAPSHOT:

IS LOS ANGELES COUNTY RIPE FOR HOTEL DEVELOPMENT?

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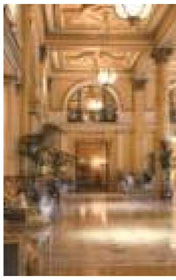

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Market Snapshot: Is Los Angeles County Ripe for Hotel Development?

Los Angeles County is one of the largest lodging submarkets in the United States. A revitalizing downtown area, one of the nation's largest international airports, a diverse local economy, and a significant entertainment presence have contributed to a strong lodging demand rebound following the recent economic recession. The following article provides an overview of three Los Angeles County lodging submarkets that may present short-term and long-term opportunities for hotel development.

The Los Angeles area is one of the world's major centers of business, entertainment, international trade, media, fashion, science, technology, and education. The county is home to multiple Fortune 500 companies, including the Walt Disney Company and Mattel, Inc. According to the Los Angeles Area Chamber of Commerce, the city is the top apparel-manufacturing center in the nation. Furthermore, Los Angeles is the largest international trade center in the U.S., with over $200 billion in imports and exports annually. Los Angeles is also known as the "Entertainment Capital of the World," with numerous motion-picture, television, and recording studios located throughout the area, in addition to hosting several annual entertainment award shows, such as the Golden Globes, the Academy Awards and the Grammys. While the entertainment industry provides tremendous support to the regional economy, the greater Los Angeles area is also a hub for finance, defense and aerospace, medical, telecommunications, manufacturing, higher-education, retail, tourism, and cultural activities.

The Los Angeles County lodging market has experienced challenges since the early 1990s, including the fluctuation of hotel supply, the rise and fall of area demand generators, and the increased meeting and convention competition from other regional metropolitan markets. Despite these historical challenges, three Los Angeles submarkets have recovered particularly well from the recent economic recession and could be considered attractive markets for hotel development. The following paragraphs describe recent trends in three of Los Angeles County's major lodging submarkets.

Downtown Los Angeles Submarket

With over 31 million square feet of office space, downtown Los Angeles is Southern California's largest office-space market and is Los Angeles County's largest commercial demand generator. The hotels located in the downtown area consist primarily of nationally branded and independent full-service hotels. In addition to hotel demand generated by the tenants in the submarket's ample office space, the Los Angeles Convention Center (LACC), Chinatown, Little Tokyo, the Arts District, the Civic Center, and the LA Live mixed-use development also generate a substantial portion of downtown's demand.

The 3.5-million-square-foot LA Live Development has been one of the driving forces behind the recent renaissance of downtown Los Angeles and also to the most recent change to the local lodging demand landscape. LA Live is located adjacent to the Staples Center and the Los Angeles

Convention Center and is a master-planned entertainment, lodging, residential, and retail development. In addition to the JW Marriott and Ritz-Carlton Hotels, which opened in early 2010, LA Live includes the Nokia Theater, the Grammy Museum, a 16-theater Regal Cinema, a Lucky Strike bowling alley, 20 restaurants that include well-known eateries, and more than 200 Ritz-Carlton-branded condominiums. The first phase of LA Live opened in October 2007 and, since opening, millions of visitors have passed through the development. It has been acclaimed a major success and has been integral in the marketing of downtown Los Angeles as a desirable leisure and group destination.

Based on our research and discussions with local market participants, lodging demand in downtown Los Angeles faltered in 2008 and 2009 due to the Great Recession. Following poor market performance in 2009, many market participants reported being uneasy regarding the opening of the JW Marriott and Ritz-Carlton Hotels and the influx of new supply into the submarket during such an uncertain economic and lodging environment. However, the 2010 opening of the JW Marriott and Ritz-Carlton Hotels induced a significant jump in demand and a much-needed spark to the downtown submarket. According to our investigation of downtown and reports from local participants, the downtown submarket's overall average rate began to recover in mid-2010, a trend that has continued to gain traction through the end of 2011. The success of LA Live and the JW Marriott and Ritz-Carlton Hotels has continued the revitalization of downtown Los Angeles. Several development projects are underway in downtown Los Angeles that are expected to further strengthen hotel demand in the medium to long term, two of which are listed below:

- A proposed 72,000-seat NFL stadium, now referred to as Farmer's Field, is currently planned to be built on the site of the existing West Hall of the LACC. Based on information provided by convention center representatives and the stadium's development team, the West Hall is planned to be demolished for the construction of the stadium and replaced with a new West Hall. The new West Hall will replace some of the LACC's dated facilities and provide the convention center with a larger, more contiguous space that is anticipated to help in attracting larger groups and conventions to downtown Los Angeles. In addition, the LACC is anticipated to undergo a general enhancement program. The proposed Farmer's Field is also planned to be used by the LACC for future events. It should be noted that as of the date of this article, Los Angeles is not home to a NFL team, but the proposed Farmer's Field is planned to attract a team in the near term. In addition, the proposed Farmer's Field is anticipated to allow Los Angeles to attract other large sports and entertainment events such as a NFL Super Bowl, NFL Pro Bowl, NCAA Final Four Tournament, Rodeos, Motor Cross, Olympic Games, and other collegiate championship tournaments.
- A major development, known as the Grand Avenue Development, is scheduled to take place in Bunker Hill, at the corner of Grand Avenue and First Street, adjacent to the Disney Concert Hall. The development is the vision of Related Companies and architect Frank Gehry. The development has been designed to mirror the Time Warner Center in New York and includes a proposed luxury hotel, condominiums, more than 280,000 square feet of retail space, and a 16-acre park connecting City Hall to the Disney Music Center. The development is anticipated to be unique in that the structures are planned to feature numerous terraces, rooftop gardens, and outdoor spaces aimed at taking advantage of the mild climate. The development has been proposed for some time and the scale of the project has been reduced due to recent economic

conditions. However, a 19-story apartment tower, adjacent to the Broad Museum, is anticipated to break ground by the beginning of the fourth quarter of 2012.

The active development projects in downtown Los Angeles are anticipated to continue to induce demand to the submarket. As a result of these developments, the overall success of LA Live, and strengthening economic conditions, several hotel projects are proposed for the downtown submarket. The most active projects with confirmed timelines are listed below:

- Adjacent to the JW Marriott and Ritz-Carlton Hotels is a site currently under development for a new 22-story hotel project that is anticipated to include a 180-room Courtyard by Marriott hotel and a 197-room Residence Inn. This project is scheduled to break ground in early 2012, with a projected opening in 2014.
- The Wilshire Grand Hotel is slated for redevelopment. The owners of the existing 896-room hotel have proposed to raze the existing improvements and construct a new two-tower development consisting of a 560-room hotel, 1.5 million square feet of office space, 100 residential units, and a 2,000-space parking structure. The existing 59-year-old hotel closed in late December 2011. Demolition is planned for the third quarter of 2012, with the new development to be completed by January 2016.

Even with these active hotel projects, the number of guestrooms in the downtown submarket is still considered to be relatively low compared to other major convention and leisure cities in California and the United States. Prior to the opening of the JW Marriott and Ritz-Carlton Hotels, the marketability of the Los Angeles Convention Center was impaired by the lack of hotels within walking distance of the convention center. Based on discussions with convention center representatives, LACC had historically lost larger city-wide conventions to other area convention centers with more committable guestrooms, such as Anaheim, San Diego, San Francisco, and Las Vegas. As an example, the LACC's major convention center competitors in Anaheim, San Diego, and San Francisco offer between 15 and 25 hotels (or approximately 7,800 to 19,000 hotel rooms) within a one-half-mile radius of their respective convention centers. While the LACC offers only 11 hotels with roundly 5,900 hotel rooms within a two-mile radius of the convention center, and only five hotels with approximately 1,600 guestrooms within a one-half mile radius of the convention center. Despite the shortage on committable guestrooms in the downtown submarket, this trend has slowly begun to change with the addition of the LA Live development and the adjacent JW Marriott and Ritz-Carlton Hotels. The city's convention & visitors bureau believes that LA Live, the JW Marriott and the Ritz-Carlton Hotels, and the recent developments surrounding Farmer's Field and LACC enhancement project should act as a catalyst in bringing new conventions and group meetings to the downtown area.

Overall, the downtown Los Angeles submarket is in the process of undergoing a major renaissance and resurgence. With several development projects underway and the general shortage of guestrooms within walking distance of the Los Angeles Convention Center, hotel investors should keep a close watch on the downtown Los Angeles submarket for upcoming opportunities in hotel development.

Westside Los Angeles Submarket

The Westside submarket is Los Angeles County's most affluent lodging submarket. It consists of luxury and upscale properties located in Beverly Hills, Bel Air, Santa Monica, Century City, and West Los Angeles. The properties in these areas include a variety of nationally recognized hotel brands or independent hotels, with many of them internationally renowned. The hotels within this submarket achieve the highest average rates of any hotels in the county; the luxury hotels in Los Angeles, which include the Beverly Hills Hotel, the Hotel Bel-Air, and the Peninsula Beverly Hills, regularly obtain some of the highest average rates in the nation. Beverly Hills and West Hollywood are considered the world headquarters for the entertainment industry, primarily in the music and film industries, which generate a significant amount of lodging demand to the area. In addition, demand in the market is also generated by various companies within the financial, legal, healthcare, and technology industries, and by an assortment of tourist and leisure attractions.

Given the high barriers to entry into the Westside market, recent hotel development within the area has included renovations or conversions of existing hotel properties rather than new-build hotels. Some of the most notable and recently completed conversions include the Bel Age Hotel converting to the London West Hollywood in April 2008; the Le Meridien Beverly Hills converting to the SLS Beverly Hills in November 2008; the Hyatt West Hollywood converting to the Andaz West Hollywood in January 2009; the Doubletree Westwood converting to the Kimpton Hotel Palomar Los Angeles in January 2009; a 1938 art deco hotel converting to the Shangri-La Santa Monica in March 2009; the Tower Beverly Hills Hotel converting to the Mr. C at Beverly Hills Hotel in April 2011; and the closure and reopening for a property-wide renovation of the Hotel Bel-Air, which occurred between October 2009 and October 2011. It should be noted that The L'Ermitage Hotel (formerly known as the Raffles L'Ermitage) was scheduled to undergo an extensive renovation and repositioning following the installation of Viceroy Hotel Group as new management of the property in early 2010, but a definite timeline for this renovation has reportedly not been secured. Although most of the area's recent hotel developments have included renovations and conversions of existing hotel buildings, three new hotels entered the submarket, including the Montage Beverly Hills in November 2008, the W Hollywood in January 2010, and the demolition of two Santa Monica motels followed by the construction of the Shore Hotel in Santa Monica in October 2011.

Despite the limited amount of developable space and the high barriers to entry, at the time of this article, several hotel projects are proposed for the Westside submarket. One of the most recent and active projects is the planned conversion of a luxury apartment building into a luxury extended-stay AKA hotel. The developing partnership of this project includes Korman Commnities, BlackRock Realty Group LLC, and the California State Teachers' Retirement System. This partnership closed on the sale of the 88-unit Crescent Beverly Hills apartment building, located proximate to Crescent Drive and Wilshire Boulevard, in early 2012 for $85 million and plan on renovating and converting the apartment building into a luxury extended-stay hotel. The project is anticipated to be completed in early 2013 and Korman Communities is reportedly also researching additional AKA extended-stay hotel projects in West Hollywood and Santa Monica. In addition to the AKA project, several proposed hotel projects continue to be in the pre-planning process in the submarket, including a proposed hotel within the Sunset Millennium mixed-use development; a proposed luxury hotel at a mixed-use development located at Sunset and Doheny; a proposed Waldorf Astoria; a proposed full-service hotel in a mixed-use development along Wilshire Boulevard in Santa Monica; and a proposed Hard Rock Hotel Los Angeles.

Performance of hotels in this submarket was negatively affected by the recent economic recession and the influx of new and repositioned hotel supply. However, the strengthening economic conditions and the submarket's large number of demand generators resulted in a sharp rebound in lodging demand in late 2010 through the end of 2011. The Westside submarket continues to be one of the most desirable lodging destinations in the United States and is anticipated to remain as an attractive submarket for hotel investors. The potential for new supply, as detailed previously, should not be a significant cause for concern in this submarket given the diverse demand base and desirability of the area.

Los Angeles International Airport Submarket

The Los Angeles International Airport (LAX) submarket is heavily dependent on the demand generated by Los Angeles International Airport, as well as numerous businesses located on the southern side of the runway in El Segundo and various demand generators in the greater LAX area. Some of these companies include Raytheon, International Rectifier, DirecTV, IBM, Boeing, and Northrop Grumman. The lodging properties in this submarket consist of large group-oriented hotels and smaller limited- and focused-service hotel facilities. LAX hotels historically derived approximately 20% of their occupancy from the airline contract segment, using this demand to create a base of occupied room nights. As a result, this submarket had been considerably more successful in terms of occupancy than other Los Angeles submarkets, achieving occupancy levels consistently 80% and above. This strategy has also imposed constraints on average rate levels in the LAX submarket due to the relatively lower average rates that characterize the airline contract segment.

Similar to other submarkets in Los Angeles County, the LAX submarket recorded a decline in demand and average rates during the most recent economic recession. However, in early 2010, demand in the LAX submarket began to rebound, and this trend continued through the end of 2011. The increase in demand is a result of increased demand from the area's corporate demand generators and also from increased activity at LAX, as shown in the following table (table 1).

TABLE 1: LOS ANGELES INTERNATIONAL AIRPORT PASSENGER STATISTICS

Year	Passenger Traffic	Percent Change*	Percent Change**
2001	61,606,253	—	—
2002	56,223,843	(8.7) %	(8.7) %
2003	54,982,838	(2.2)	(5.5)
2004	60,704,568	10.4	(0.5)
2005	61,489,523	1.3	(0.0)
2006	61,041,066	(0.7)	(0.2)
2007	62,438,583	2.3	0.2
2008	59,820,750	(4.2)	(0.4)
2009	56,520,843	(5.5)	(1.1)
2010	59,069,409	4.5	(0.5)
Year-to-date, November			
2010	54,020,270	—	—
2011	56,830,879	5.2 %	—

*Annual average compounded percentage change from the previous year

**Annual average compounded percentage change from first year of data

Source: Los Angeles International Airport

Los Angeles International Airport is the primary airport serving the Los Angeles market area. With service to destinations in North America, Latin America, Europe, Asia, and Oceania, LAX is the third-busiest airport in the U.S. and the second-busiest international gateway, behind JFK International Airport in New York City. In February 2010, construction began on the Bradley West Project, a long-awaited major modernization of the Tom Bradley International Terminal at LAX. The $1.545 billion project will create a new world-class terminal that will offer travelers the very best in airport amenities, adding over 1,250,000 square feet of shops, restaurants, and passenger lounges, as well as new security screening, customs and immigration, and baggage claim facilities. The terminal's existing two concourses will be demolished and replaced with a larger pair, inclusive of 16 gates. The project is expected to be completed in early 2014. Based on information released by airport representatives, airline demand for the new Bradley Terminal is currently very high and several major airlines are jockeying to reserve gates at the new terminal.

Given the LAX submarket's current low average rate levels, new hotel development in the immediate future is considered unlikely. The near-term hotel supply landscape in the LAX submarket is expected to be characterized primarily by conversions and renovations to the area's existing properties. Over the long term, strong average rate gains in the Los Angeles County area and continued high occupancy levels within the LAX submarket are anticipated to increase the LAX average rates and should once again support new hotel development within this submarket.

Conclusion

Los Angeles County is one of the nation's most diverse lodging markets. Although affected by the recent economic recession, demand has rebounded in the past two years and with limited new hotel supply on the horizon given the high barriers to entry and development costs in Los Angeles, hoteliers are expecting strong gains in RevPAR in the coming years as recent macroeconomic headwinds fade. In the near term, hotel investors should pay close attention to the changing demand landscape in downtown, as LA Live and upcoming new demand generators are expected to continue transforming this lodging submarket. The Westside submarket persists as an attractive and desirable market for hotel investors, while the opportunities for hotel development in the LAX submarket should be re-evaluated once more stable economic conditions can provide for additional average rate growth.

About HVS

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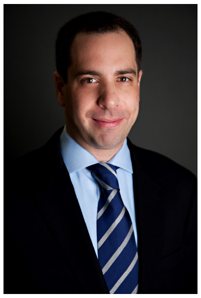
About the Authors



Jamie Schwartz is a Vice President in HVS' San Francisco office. He has a B. Com. from McGill University and an M.M.H. degree from Cornell University's School of Hotel Administration. Jamie has performed numerous appraisals, feasibility studies, and consulting assignments with HVS and had additional professional experience at Fairmont Hotel and Resorts.

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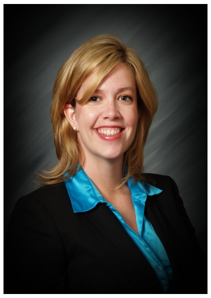

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