U.S. LODGING MARKET UPDATE
OPERATING AT A HIGH LEVEL
SEPTEMBER 27, 2016

Mark Woodworth
CBRE Hotels’ Americas Research
AGENDA

✓ Is the End Near?
✓ Our Forecasts – The Nation
✓ Leaders and Laggards
✓ Airbnb Update
✓ The Profit Picture
✓ Cap Rate Forecast
QUESTION:

HOW DO YOU FEEL ABOUT THE ECONOMY TODAY?

Good?
Okay?
Bad?
ANOTHER QUESTION:

WHAT WILL THE ECONOMY BE LIKE A YEAR FROM TODAY?

Same?  
Better? 
Worse?
WHAT COULD DERAIL THE GOOD TIMES?

1. The Economy
2. Over Building
3. Unpredictable Demand Shock
4. Oil/Energy Price Increases
5. Asset Price Bubble
SOME THOUGHTS ON THE ECONOMY

These matter the most.

Source: BEA, Moody’s Analytics, CBRE Hotels Hotel Horizons: September 2016, STR
ECONOMIC ASSUMPTIONS BEHIND OUR FORECASTS
A STRONGER 2017 IS EXPECTED

<table>
<thead>
<tr>
<th>Year</th>
<th>CPI ^</th>
<th>GMP (GDP) ^</th>
<th>Income ^</th>
<th>Employment ^</th>
<th>Corporate Profits ^</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>0.1%</td>
<td>2.4%</td>
<td>4.3%</td>
<td>2.1%</td>
<td>-3.1%</td>
</tr>
<tr>
<td>2016F</td>
<td>1.3%</td>
<td>2.1%</td>
<td>2.7%</td>
<td>1.7%</td>
<td>-2.9%</td>
</tr>
<tr>
<td>2017F</td>
<td>2.4%</td>
<td>2.9%</td>
<td>3.3%</td>
<td>1.2%</td>
<td>1.0%</td>
</tr>
</tbody>
</table>

Source: CBRE Econometric Advisors, Moody's Analytics
U.S. LODGING INDUSTRY
CHANGE IN SUPPLY AND ADR
A PROFILE OF LOW AND HIGH SUPPLY GROWTH MARKETS

- Low Supply Growth = Less than 2.0%
- High Supply Growth = Greater than 2.0%

<table>
<thead>
<tr>
<th>Measure</th>
<th>Low Supply</th>
<th>High Supply</th>
</tr>
</thead>
<tbody>
<tr>
<td>Occupancy Change</td>
<td>+0.6%</td>
<td>-1.5%</td>
</tr>
<tr>
<td>ADR Change</td>
<td>+4.1%</td>
<td>+2.2%</td>
</tr>
<tr>
<td>RevPAR Change</td>
<td>+4.8%</td>
<td>+0.6%</td>
</tr>
<tr>
<td>Supply Change</td>
<td>+1.0%</td>
<td>+4.0%</td>
</tr>
<tr>
<td>Demand Change</td>
<td>+1.6%</td>
<td>+2.4%</td>
</tr>
</tbody>
</table>

• Occupancy Level: 71.4%

Source: CBRE Hotels’ Americas Research, September – November 2016 Hotel Horizons® Forecast
### U.S. BASELINE FORECAST

**OCCUPANCY PEAKS AND ADR GROWTH PICKS UP**

<table>
<thead>
<tr>
<th></th>
<th>Long Run Average</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016F</th>
<th>2017F</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Supply</strong></td>
<td>1.9%</td>
<td>0.6%</td>
<td>0.7%</td>
<td>1.1%</td>
<td>1.6%</td>
<td>2.0%</td>
</tr>
<tr>
<td><strong>Demand</strong></td>
<td>2.0%</td>
<td>2.0%</td>
<td>4.3%</td>
<td>2.7%</td>
<td>1.7%</td>
<td>1.8%</td>
</tr>
<tr>
<td><strong>Occupancy</strong></td>
<td>62.0%</td>
<td>62.2%</td>
<td>64.4%</td>
<td><strong>65.4%</strong></td>
<td>65.5%</td>
<td>65.4%</td>
</tr>
<tr>
<td><strong>ADR</strong></td>
<td>3.0%</td>
<td>3.8%</td>
<td>4.5%</td>
<td>4.5%</td>
<td>3.5%</td>
<td>4.1%</td>
</tr>
<tr>
<td><strong>RevPAR</strong></td>
<td>3.2%</td>
<td>5.2%</td>
<td>8.2%</td>
<td>6.2%</td>
<td>3.6%</td>
<td>3.9%</td>
</tr>
</tbody>
</table>

**RECORD HIGH OCCUPANCY WAS ACHIEVED IN 2015, WILL 2016 BE EVEN BETTER?**

*Source: CBRE Hotels’ Americas Research - Hotel Horizons®  September – November 2016; STR*
LEADING AND LAGGING MARKETS
TIMES ARE GOOD FOR MOST, BUT NOT ALL

THE BUSINESS CYCLE
TIMES ARE GOOD FOR MOST, BUT NOT ALL – CHAIN SCALES

REVPAR CHANGE FROM PREVIOUS PEAK

TIMES ARE GOOD FOR MANY, BUT NOT ALL – MARKETS

REVPAR CHANGE FROM PREVIOUS PEAK

AIRBNB UPDATE
AIRBNB IN THE U.S.
LAST 12 MONTHS (JULY 2015 – JUNE 2016)

Just in the United States:

• 57.2 Million Units Available (+110%)
• 27.5 Million Units Sold (+104%)
• $4.7 Billion in Revenue Generated (+135%)

Source: CBRE Hotels’ Americas Research; Airdna, Q2 2016.
REVENUES, EXPENSES AND PROFITS
U.S. LODGING INDUSTRY
2016 TRENDS® IN THE HOTEL INDUSTRY

Annual Change in Expenses* - Real

Note: * Before deduction for Management Fees and Non-Operating Income and Expenses
Source: 2016 Trends® in the Hotel Industry
2016 TRENDS® IN THE HOTEL INDUSTRY

Annual Change in Hospitality Hourly Compensation versus Unemployment Rate

2016 TRENDS® IN THE HOTEL INDUSTRY

Annual Change in Components of Labor Costs

- Total Salaries, Wages, Service Charges, Contracted Labor and Bonuses - 2000-2015 CAGR = 1.5%
- Payroll Related Expenses (Benefits) - 2000-2015 CAGR = 2.7%


Source: 2016 Trends® in the Hotel Industry

CBRE
PRESSURE ON SALARIES AND WAGES

• LOW LEVELS OF UNEMPLOYMENT
• MINIMUM WAGE / LIVING WAGE LEGISLATION
• RAISING THE OVERTIME THRESHOLD
• JOINT-EMPLOYER STANDARDS
2016 TRENDS® IN THE HOTEL INDUSTRY

Annual Change in Revenues and Expenses∗

Note: ∗ Before deduction for Management Fees and Non-Operating Income and Expenses
### 2016 Trends® in the Hotel Industry

Gross Operating Profit* - Dollars Per Available Room

**Note:** *Before deduction for Management Fees and Non-Operating Income and Expenses*

**Source:** 2016 Trends® in the Hotel Industry, September 2016 Hotel Horizons® Forecast

**Hotel Horizons® Forecast**

63.0% from 2009 to 2015

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**Note:** *Before deduction for Management Fees and Non-Operating Income and Expenses*

**Source:** 2016 Trends® in the Hotel Industry, September 2016 Hotel Horizons® Forecast
CAP RATE FORECASTS
HOTEL CAP RATE FORECASTING MODEL

Market Return, Risk, and Income Growth (from Gordon Growth Model)

Data

- RERC Survey/RCA Trans.
- Forward Market/CBRE EA/Moody’s Analytics
- Hotel Horizons/STR

Variables

- Hotel Cap Rate ($R_{hotel}$)
- Risk Free Rate (10-Year Treasury)
- Risk Premium (Moody’s Baa – 10-Year Treasury)
- Income Growth ($\Delta \text{NOI}$)

Contribution*:

- Hotel Cap Rate ($R_{hotel}$): 31%
- Risk Free Rate (10-Year Treasury): 27%
- Risk Premium (Moody’s Baa – 10-Year Treasury): 36%

*other variables such as debt/GDP ratio are used which contribute <6% in predictive power

*2005-2015
CAP RATE FORECASTING METHOD AND DATA SOURCES

- Four exogenous predictive variables: \( \Delta \text{NOI} \), 10-year Treasuries, Baa Bond yield-to-10-year treasury spread, change in Real Estate Debt to GDP Ratio
- Two sources forecast 10-Year Treasuries yield
  - Moody’s Analytics Forecast
  - Market Expectations
- Two sources for Baa bond yield forecasts
  - Moody’s Analytics Forecast
  - Mean Reversion Forecast

Sources: CBRE Econometric Advisors, CBRE Hotels’ Americas Research, Moody’s Analytics. Q3 2016.
RISING INTEREST RATES AND RISK SPREADS
Baa Bonds Minus 10-Year Treasury

Sources; CBRE Hotels’ Americas Research, Moody’s. Q3 2016.
RISING RATES AND HOTEL RISK

Hotel Cap Rates Minus Baa Bonds

Long Run Average = 3.53%

Forecast

Mean Reversion

Sources: CBRE Hotels’ Americas Research, Moody’s Analytics. Q3 2016.
### WHERE ARE CAP RATES GOING? BASED ON MARKET EXPECTATIONS

<table>
<thead>
<tr>
<th>Year</th>
<th>10-Year Treasury</th>
<th>Risk Premium (Baa - 10-Yr Treasury)</th>
<th>Real Estate Risk Premium (Hotel Cap Rate – Baa)</th>
<th>Hotel Cap Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>3.22</td>
<td>1.38</td>
<td>4.32</td>
<td>8.92</td>
</tr>
<tr>
<td>2011</td>
<td>2.78</td>
<td>1.11</td>
<td>4.29</td>
<td>8.18</td>
</tr>
<tr>
<td>2012</td>
<td>1.81</td>
<td>1.33</td>
<td>4.93</td>
<td>8.07</td>
</tr>
<tr>
<td>2013</td>
<td>2.35</td>
<td>1.26</td>
<td>4.42</td>
<td>8.03</td>
</tr>
<tr>
<td>2014</td>
<td>2.54</td>
<td>1.07</td>
<td>4.15</td>
<td>7.76</td>
</tr>
<tr>
<td>2015</td>
<td>2.14</td>
<td>1.46</td>
<td>4.01</td>
<td>7.61</td>
</tr>
<tr>
<td>2016F</td>
<td>1.71</td>
<td>1.37</td>
<td>4.97</td>
<td>8.06</td>
</tr>
<tr>
<td>2017F</td>
<td>1.71</td>
<td>1.43</td>
<td>5.06</td>
<td>8.20</td>
</tr>
<tr>
<td>2018F</td>
<td>1.84</td>
<td>1.66</td>
<td>4.85</td>
<td>8.35</td>
</tr>
</tbody>
</table>


Cap rates will remain below the LRA

Source: CBRE Hotels’ Americas Research, US Treasury, RERC, RCA
SUMMARY
SUMMARY THOUGHTS

Operating at a High Level

1. The fundamentals remain attractive across the vast majority of markets.

2. Industry growth will persist comfortably through 2017 and likely beyond.

3. High occupancy levels should provide the leverage needed to achieve attractive ADR increases for the next two-three years.

4. Modest (but increasing) hotel construction is to be expected; the threat of over building is absent from most markets.

5. Above long run average occupancy levels will lead to revenue growth sufficient to off-set increasing labor costs, thus resulting in attractive profit growth for most.

6. Steady, if unremarkable, growth is to be expected overall. Some markets certainly better than others.
CBRE HOTELS
The World's Leading Hotel Experts.

R. Mark Woodworth
Senior Managing Director
+1 404 809 3969
mark.woodworth@cbre.com
3475 Lenox Road NE
Suite 720
Atlanta, GA 30326
www.cbrehotels.com

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