

TRENDS

IN THE HOTEL INDUSTRY Northern California



July 2010

AN ANALYSIS OF FUTURE DELINQUENCY FOR HOTEL CMBS LOANS

By Jack Corgel, Ph. D. and Aaron Walls

Almost daily reports from the financial press and securities analysts document an emerging problem in the banking and securitized loan sectors of potentially gigantic proportions stemming from weakening commercial real estate (CRE) cash flows and property prices that have already begun to manifest in loan delinquencies, defaults, and monetary losses.¹ As property values sink below loan balances, borrowers become increasingly incentivized to withhold payments and relinquish ownership to lenders. Recent foreclosure experience in the U.S. housing markets seems certain to be repeated in the CRE markets.

Hotel real estate occupies a position at the leading edge of the coming CRE storm. Without lease contracts, hotels have direct exposure to demand downturns. Overbuilding in hotel markets also has been a problem during some previous recessions as supply growth continues in the presence of

sudden drop offs in demand. A carefully performed analysis of impending financial stress resulting from hotel loan delinquency and default has important implications for benchmarking the severity of impending CRE loan problems among banks and commercial mortgage-backed security (CMBS) investors, and forecasting future capital flows in the hotel sector.

Colliers PKF-HR has developed automated financial planning tools to forecast hotel net operating incomes (NOI) and property values that, when combined with debt service obligations and loan amounts, enable objective estimations of future hotel loan performance. Using this approach, Colliers PKF-HR was able to prepare a thorough examination of the potential for the future delinquency of 365 hotel CMBS loans. Such an analysis is invaluable to:

- Special Servicers
- Lenders
- Investors
- Operators
- Attorneys
- Government Regulators

¹ See, for example, Pewter Eavis, "Lenders Open to real-Estate Pain," *Wall Street Journal*, April 10, 2010. The first sentence in this article is "A slow motion train wreck is still a train wreck."

Estimates of Future Delinquency

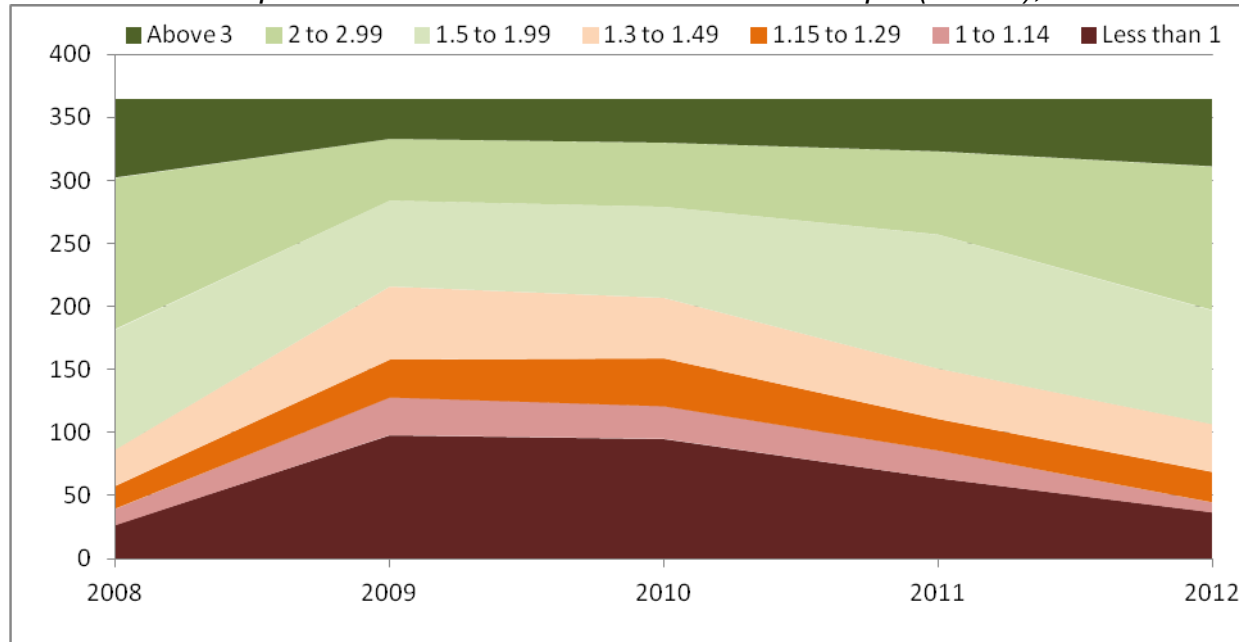
The following paragraphs and exhibits summarize the results of the Colliers PKF-HR analysis.

The debt coverage ratios (DCRs) of the 365 hotels for which we estimated debt service payments and NOIs through 2012 are shown in Exhibit 1 for each year beginning in 2008. According to the 2010 Colliers PKF-HR *Hospitality Investment Survey*, lenders require DCRs for hotels equal to approximately 1.50. Below this level a hotel loan may approach loan covenant levels that eventually may lead to technical default if additional equity is not invested by borrowers. At a DCR of less than 1.0, loans are in serious jeopardy of delinquency.

Exhibit 1: DCRs for Hotel Sample (N=365), 2008-2012

DCR	Year				
	2008	2009	2010	2011	2012
Above 3	63	32	35	42	54
2 to 2.99	120	49	51	66	114
1.5 to 1.99	96	68	72	106	90
1.3 to 1.49	29	58	48	40	38
1.15 to 1.29	18	30	38	25	24
1 to 1.14	13	30	26	22	8
Less than 1	27	98	95	64	37
Total	365	365	365	365	365

Exhibit 2: Graphical Presentation of DCRs for Hotel Sample (N=365), 2008-2012



TRENDS is compiled and produced by PKF Consulting. Readers are advised that PKF Consulting does not represent the data contained herein to be definitive. Neither should the contents of this publication be construed as a recommendation of policies or actions. Quotation and reproduction of this material are permitted with credit to PKF Consulting.

At the beginning of the study period in 2008, 87 of the 365 hotels had DCRs less than 1.5, of which 27 were less than 1.0. Our DCR estimates for 2010 indicate a clear deterioration of loan security. Of the 365 hotels, 95 (26%) have estimated DCRs less than 1.0 and 207 (57%) have DCRs below 1.5. The percent of hotels with DCRs below 1.0 exceeds the 18 percent delinquency rate for hotel loans reported by Fitch, suggesting the potential for delinquency has not been fully reached. Fitch also forecasts the hotel delinquency rate to reach 30 percent by 2012.² Our analysis, based on econometric forecasts of hotel room revenues and modeled NOIs, reveals improvement of hotel loan security and a return to approximately 2009 delinquency by 2012. We expect the peak of CMBS hotel loan problems to occur in 2010, but expect only gradual improvement in 2011. By 2012 hotel NOI growth should begin to relieve some of the stress on hotel delinquency.

Conclusion

The financial environment in which hotels operate has deteriorated precipitously since the end of 2007, and years 2010 and 2011 will be extremely challenging for hotel operators, owners, and special servicers. With almost more than a quarter of the CMBS loan portfolio unable to meet debt service obligations, the special servicers of those loans will need to understand if properties can be worked out or should be liquidated. We are the first to directly examine individual hotels' ability to pay when forecasting hotel loan performance issues. The results of our

analyses demonstrate a clear peak in hotel delinquencies during 2010, with 2011 showing an increase in NOI performance that relieves the downward pressure of the preceding two years.

A report on hotel default based on the relationship between future hotel property values and loan balances will be issued in the coming weeks.

The Full Report

A full description of the research methodology and results can be found in the 2010 edition of *Trends® in the Hotel Industry*. To purchase a copy of the 2010 Trends® report, please visit our webstore at www.pkfc.com/store, or call 866-842-8754.

About The Authors

John B. (Jack) Corgel, Ph. D. is the Robert C. Baker Professor of Real Estate at the Cornell University School of Hotel Administration and Senior Advisor to Colliers PKF Hospitality Research. Aaron Walls is a Research Analyst with Colliers PKF Hospitality Research.

² See "US Hotel Loan Default Rate May Double by 2010-Fitch" *Reuters*, March 22, 2010.

TRENDS is compiled and produced by PKF Consulting. Readers are advised that PKF Consulting does not represent the data contained herein to be definitive. Neither should the contents of this publication be construed as a recommendation of policies or actions. Quotation and reproduction of this material are permitted with credit to PKF Consulting.

**STATISTICS AND TRENDS OF HOTEL-MOTEL BUSINESS
NORTHERN CALIFORNIA MONTHLY TRENDS
MONTH OF JULY**

REPORT OF ROOMS BUSINESS BY LOCATION

	AVERAGE DAILY ROOM RATE			OCCUPANCY PERCENT		
	2010	2009	VAR	2010	2009	VAR
SAN FRANCISCO	\$158.16	\$152.44	3.7%	88.4%	86.0%	2.7%
SAN FRANCISCO AIRPORT	103.14	102.88	0.3%	83.7%	79.8%	4.9%
SAN JOSE/PENINSULA	111.86	110.59	1.1%	71.8%	64.0%	12.2%
OAKLAND/EAST BAY	93.14	94.17	-1.1%	69.5%	62.0%	12.0%
MONTEREY/CARMEL	227.94	208.76	9.2%	79.9%	76.0%	5.2%
CENTRAL VALLEY	72.06	77.16	-6.6%	65.8%	62.5%	5.3%
SACRAMENTO	88.92	91.26	-2.6%	66.7%	57.0%	17.0%
MARIN COUNTY	131.67	138.91	-5.2%	81.4%	77.9%	4.5%
NAPA COUNTY	228.79	213.24	7.3%	77.4%	74.8%	3.4%
SONOMA COUNTY	138.22	131.80	4.9%	76.9%	71.9%	7.0%
OTHER NORTHERN CALIFORNIA	97.04	92.67	4.7%	73.6%	69.8%	5.4%
OVERALL AVERAGE	\$126.03	\$124.60	1.2%	76.9%	72.0%	6.8%

REPORT OF ROOMS BUSINESS BY AVERAGE DAILY RATE

	AVERAGE DAILY ROOM RATE			OCCUPANCY PERCENT		
	2010	2009	VAR	2010	2009	VAR
OVER \$175.00	\$242.45	\$224.37	8.1%	82.4%	76.0%	8.4%
\$125.00 TO \$175.00	146.93	143.70	2.2%	82.8%	79.5%	4.2%
\$75.00 TO \$125.00	100.50	102.21	-1.7%	74.7%	67.7%	10.4%
UNDER \$75.00	54.08	55.68	-2.9%	67.1%	64.0%	4.8%
OVERALL AVERAGE	\$126.03	\$124.60	1.2%	76.9%	72.0%	6.8%

REPORT OF ROOMS BUSINESS BY SIZE OF PROPERTY

	AVERAGE DAILY ROOM RATE			OCCUPANCY PERCENT		
	2010	2009	VAR	2010	2009	VAR
OVER 400 ROOMS	\$141.38	\$141.04	0.2%	82.6%	78.7%	5.0%
250 TO 400 ROOMS	146.68	138.51	5.9%	76.4%	70.1%	8.9%
150 TO 250 ROOMS	134.60	130.58	3.1%	77.5%	73.8%	5.0%
UNDER 150 ROOMS	98.62	99.48	-0.9%	72.9%	67.3%	8.4%
OVERALL AVERAGE	\$126.03	\$124.60	1.2%	76.9%	72.0%	6.8%

TRENDS is compiled and produced by PKF Consulting. Readers are advised that PKF Consulting does not represent the data contained herein to be definitive. Neither should the contents of this publication be construed as a recommendation of policies or actions. Quotation and reproduction of this material are permitted with credit to PKF Consulting.

**STATISTICS AND TRENDS OF HOTEL-MOTEL BUSINESS
SAN FRANCISCO MONTHLY TRENDS
MONTH OF JULY**

REPORT OF ROOMS BUSINESS BY LOCATION

	AVERAGE DAILY ROOM RATE			OCCUPANCY PERCENT		
	2010	2009	VAR	2010	2009	VAR
UNION/NOB/MOSCONE	\$159.63	\$156.22	2.2%	87.8%	84.8%	3.5%
FINANCIAL DISTRICT	182.59	179.10	1.9%	86.1%	85.6%	0.6%
FISHERMAN'S WHARF	164.03	148.15	10.7%	92.6%	93.1%	-0.5%
CIVIC CENTER/VAN NESS	116.42	107.76	8.0%	88.5%	84.2%	5.0%
OVERALL AVERAGE	\$158.16	\$152.44	3.7%	88.4%	86.0%	2.7%

REPORT OF ROOMS BUSINESS BY AVERAGE DAILY RATE

	AVERAGE DAILY ROOM RATE			OCCUPANCY PERCENT		
	2010	2009	VAR	2010	2009	VAR
OVER \$200.00	\$244.67	\$225.75	8.4%	84.6%	78.2%	8.1%
\$150.00 TO \$200.00	166.96	161.38	3.5%	88.3%	87.1%	1.5%
\$150.00 AND UNDER	131.70	129.34	1.8%	89.3%	86.8%	2.8%
OVERALL AVERAGE	\$158.16	\$152.44	3.7%	88.4%	86.0%	2.7%

REPORT OF ROOMS BUSINESS BY SIZE OF PROPERTY

	AVERAGE DAILY ROOM RATE			OCCUPANCY PERCENT		
	2010	2009	VAR	2010	2009	VAR
OVER 400 ROOMS	\$153.45	\$153.42	0.0%	89.3%	87.4%	2.2%
250 TO 400 ROOMS	180.98	164.79	9.8%	85.6%	81.7%	4.8%
150 TO 250 ROOMS	154.78	145.19	6.6%	89.5%	89.4%	0.1%
UNDER 150 ROOMS	138.31	129.68	6.7%	88.1%	84.0%	4.8%
OVERALL AVERAGE	\$158.16	\$152.44	3.7%	88.4%	86.0%	2.7%

TRENDS is compiled and produced by PKF Consulting. Readers are advised that PKF Consulting does not represent the data contained herein to be definitive. Neither should the contents of this publication be construed as a recommendation of policies or actions. Quotation and reproduction of this material are permitted with credit to PKF Consulting.

**STATISTICS AND TRENDS OF HOTEL-MOTEL BUSINESS
NORTHERN CALIFORNIA MONTHLY TRENDS
SEVEN MONTHS ENDED JULY**

REPORT OF ROOMS BUSINESS BY LOCATION

	AVERAGE DAILY ROOM RATE			OCCUPANCY PERCENT		
	2010	2009	VAR	2010	2009	VAR
SAN FRANCISCO	\$153.53	\$156.68	-2.0%	78.0%	72.5%	7.6%
SAN FRANCISCO AIRPORT	103.28	108.53	-4.8%	72.8%	67.5%	7.7%
SAN JOSE/PENINSULA	115.43	119.67	-3.5%	68.3%	57.5%	18.7%
OAKLAND/EAST BAY	93.90	100.09	-6.2%	62.5%	58.1%	7.6%
MONTEREY/CARMEL	207.46	190.51	8.9%	63.1%	59.9%	5.4%
CENTRAL VALLEY	74.17	77.14	-3.8%	61.1%	61.7%	-0.9%
SACRAMENTO	91.52	97.72	-6.3%	62.2%	60.1%	3.5%
MARIN COUNTY	122.60	132.43	-7.4%	62.4%	62.1%	0.5%
NAPA COUNTY	199.71	205.52	-2.8%	63.8%	61.0%	4.5%
SONOMA COUNTY	119.69	122.09	-2.0%	61.1%	58.4%	4.6%
OTHER NORTHERN CALIFORNIA	88.01	88.50	-0.5%	59.5%	59.0%	1.0%
OVERALL AVERAGE	\$122.42	\$126.08	-2.9%	68.3%	63.6%	7.3%

REPORT OF ROOMS BUSINESS BY AVERAGE DAILY RATE

	AVERAGE DAILY ROOM RATE			OCCUPANCY PERCENT		
	2010	2009	VAR	2010	2009	VAR
OVER \$175.00	\$228.98	\$225.21	1.7%	70.0%	64.9%	7.9%
\$125.00 TO \$175.00	143.11	146.17	-2.1%	74.2%	68.5%	8.4%
\$75.00 TO \$125.00	100.19	106.68	-6.1%	66.7%	61.3%	8.8%
UNDER \$75.00	52.80	55.13	-4.2%	59.5%	58.5%	1.6%
OVERALL AVERAGE	\$122.42	\$126.08	-2.9%	68.3%	63.6%	7.3%

REPORT OF ROOMS BUSINESS BY SIZE OF PROPERTY

	AVERAGE DAILY ROOM RATE			OCCUPANCY PERCENT		
	2010	2009	VAR	2010	2009	VAR
OVER 400 ROOMS	\$142.78	\$148.41	-3.8%	75.3%	69.9%	7.7%
250 TO 400 ROOMS	139.74	141.59	-1.3%	67.3%	61.4%	9.5%
150 TO 250 ROOMS	127.36	129.97	-2.0%	67.8%	62.9%	7.7%
UNDER 150 ROOMS	93.72	96.55	-2.9%	64.2%	60.7%	5.8%
OVERALL AVERAGE	\$122.42	\$126.08	-2.9%	68.3%	63.6%	7.3%

TRENDS is compiled and produced by PKF Consulting. Readers are advised that PKF Consulting does not represent the data contained herein to be definitive. Neither should the contents of this publication be construed as a recommendation of policies or actions. Quotation and reproduction of this material are permitted with credit to PKF Consulting.

**STATISTICS AND TRENDS OF HOTEL-MOTEL BUSINESS
SAN FRANCISCO MONTHLY TRENDS
SEVEN MONTHS ENDED JULY**

REPORT OF ROOMS BUSINESS BY LOCATION

	AVERAGE DAILY ROOM RATE			OCCUPANCY PERCENT		
	2010	2009	VAR	2010	2009	VAR
UNION/NOB/MOSCONE	\$162.02	\$166.78	-2.9%	77.2%	72.0%	7.2%
FINANCIAL DISTRICT	185.97	187.44	-0.8%	78.7%	71.8%	9.6%
FISHERMAN'S WHARF	129.59	129.58	0.0%	82.8%	75.8%	9.2%
CIVIC CENTER/VAN NESS	100.68	101.86	-1.2%	75.8%	71.9%	5.3%
OVERALL AVERAGE	\$153.53	\$156.68	-2.0%	78.0%	72.5%	7.6%

REPORT OF ROOMS BUSINESS BY AVERAGE DAILY RATE

	AVERAGE DAILY ROOM RATE			OCCUPANCY PERCENT		
	2010	2009	VAR	2010	2009	VAR
OVER \$200.00	\$239.79	\$242.13	-1.0%	75.2%	67.1%	12.2%
\$150.00 TO \$200.00	162.44	166.05	-2.2%	80.5%	74.9%	7.4%
\$150.00 AND UNDER	125.37	128.99	-2.8%	76.3%	71.5%	6.7%
OVERALL AVERAGE	\$153.53	\$156.68	-2.0%	78.0%	72.5%	7.6%

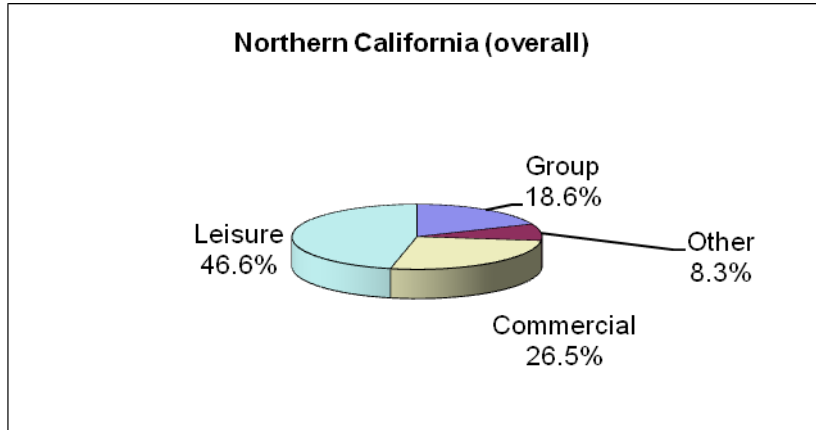
REPORT OF ROOMS BUSINESS BY SIZE OF PROPERTY

	AVERAGE DAILY ROOM RATE			OCCUPANCY PERCENT		
	2010	2009	VAR	2010	2009	VAR
OVER 400 ROOMS	\$153.43	\$159.65	-3.9%	79.8%	75.1%	6.3%
250 TO 400 ROOMS	168.42	167.49	0.6%	73.4%	66.1%	11.0%
150 TO 250 ROOMS	146.27	147.26	-0.7%	79.6%	73.5%	8.3%
UNDER 150 ROOMS	129.84	128.85	0.8%	76.5%	71.1%	7.6%
OVERALL AVERAGE	\$153.53	\$156.68	-2.0%	78.0%	72.5%	7.6%

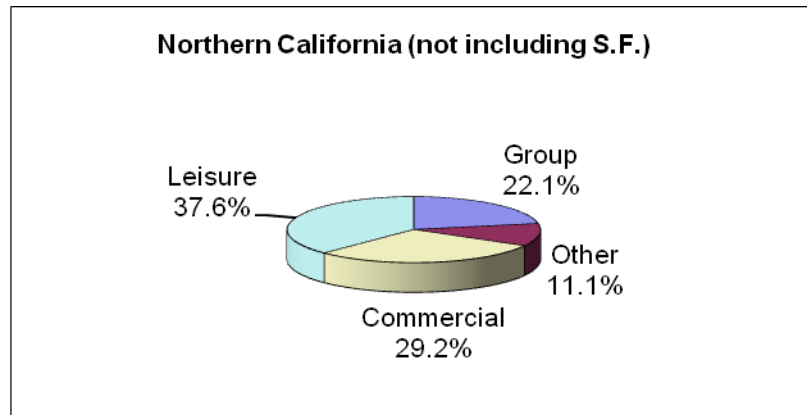
TRENDS is compiled and produced by PKF Consulting. Readers are advised that PKF Consulting does not represent the data contained herein to be definitive. Neither should the contents of this publication be construed as a recommendation of policies or actions. Quotation and reproduction of this material are permitted with credit to PKF Consulting.

Market Mix – July 2010

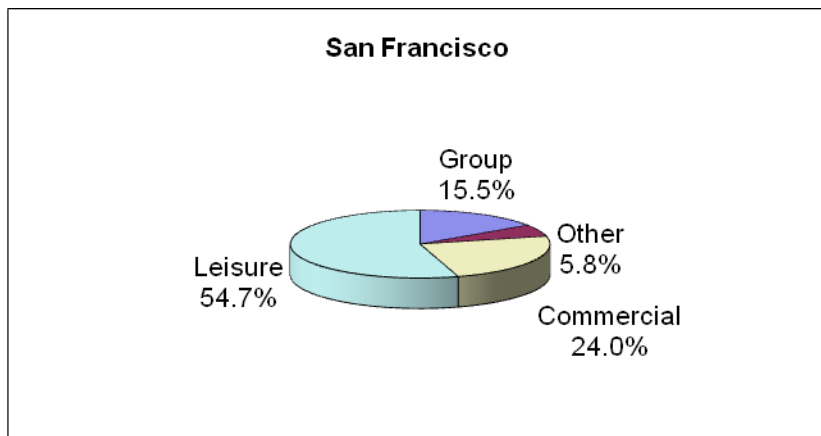
Northern California (Overall)



Northern California (not including S.F.)



San Francisco



TRENDS is compiled and produced by PKF Consulting. Readers are advised that PKF Consulting does not represent the data contained herein to be definitive. Neither should the contents of this publication be construed as a recommendation of policies or actions. Quotation and reproduction of this material are permitted with credit to PKF Consulting.