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**FEBRUARY 10th - 12th, 2014**

# ANALYZING THE DEAL

Rachel Roginsky, Pinnacle Advisory Group

Karen Johnson, Pinnacle West

Emily Smith, RLJ Lodging

# PRESENTERS



**Rachel Roginsky, ISHC – Principal,  
Owner/founder Pinnacle Advisory Group**

- 35 years hospitality consulting experience
- President – ISHC
- BS degree from Cornell University School of Hotel Administration
- Regular speaker @ hotel industry events and prestigious colleges/universities



**Karen Johnson, CRE, ISHC, MAI – President  
Pinnacle West**

- 35 years hospitality consulting experience
- Alum of Marriott's internal feasibility department, and JLL, one of the largest hotel brokers in the world
- BS degree-Michigan State University School of Hotel, Restaurant & Institutional Mgmt
- Regular speaker @ hotel industry events



**Emily U. Smith, Associate Director –  
Investment & Portfolio Analysis, RLJ Lodging  
Trust**

- RLJ Lodging Trust owns 150 properties in 23 states and Washington, D.C.
- Previously with HVS – New York
- Master's degree from Conrad N. Hilton College of Hotel & Restaurant Management

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# ANALYZING THE DEAL

# AGENDA

## 1. Present the deal flow process

- Background of hotel basics: attributes, relevant terms
- Typical marketing process for brokered deals
- Initial screening, projections, and other “behind the scenes” analyses
- Tours and on-site market due diligence
- Bidding process
- More exhaustive due diligence (heavy legal dependence)
- Best & Final round
- “Going hard”
- Closing

## 2. Case Study: Review a hypothetical hotel purchase in the Houston Galleria



# OBJECTIVE

**How will this presentation help you in your daily work?**

- **Understand some terms and concepts that you may hear thrown around the office**
- **Understand where what you do fits into the bigger picture of hotel ownership and investment**
- **Identify opportunities to improve your company's processes**



# HOW ARE HOTELS DIFFERENT?

**Not your typical commercial real estate...**

- 24-hour leases
- Operating businesses
- Long-term property management contracts
- Branding and brand standards
- Continuous, compulsory capital expenditures
- Lots of employees



# DEFINITIONS & JARGON

## ■ HOTEL FINANCE PREREQUISITES:

- 1. Occupancy
  - a. Available Room Nights
  - b. Occupied Room Nights
- 2. ADR
- 3. RevPAR

## ■ HOTEL FINANCE 101: Reading a Profit & Loss (P&L) Statement

- 1. Uniform System of Accounts
- 2. House Profit
- 3. Net Operating Income (NOI)
- 4. Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)
- 5. Expense Margin
- 6. Per Occupied Room
- 7. Per Available Room
- 8. Reserve for Replacement (FF&E Reserve)





# DEFINITIONS & JARGON, CONT'D

## ■ HOTEL FINANCE 201: Financial Projections

- 1. Pro forma
- 2. Discounted Cash Flow Analysis (DCF)
- 3. Exit / Reversion
- 4. Cap Rate
- 5. Discount Rate
- 6. Internal Rate of Return (IRR)
- 7. Preferred Return

## ■ HOTEL FINANCE 202: Investment Analysis

- 1. Smith Travel Research (STAR reports, data)
- 2. Penetration
- 3. Franchise
- 4. Management Agreement
- 5. Encumbered
- 6. Property Improvement Plan (PIP)
- 7. Area of Protection (AOP)





# CASE STUDY

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## Potential hotel acquisition of a proposed upscale, full-service hotel in the Houston Galleria area



# BROKER MARKETING PROCESS

## ■ How are hotels typically marketed?



- 1. Seller engages brokerage firm
- 2. Broker sends out flyers or “teasers”; e-mail blasts to relevant parties
- 3. Interested parties execute confidentiality agreements
- 4. Broker distributes Offering Memorandums – the sales pitch
- 5. Interested parties gain virtual deal room access
- 6. Potential buyers start calling around to gain “the scoop”

# CASE STUDY: BROKER PITCH & GUIDANCE

- **Mr. Hotshot Broker has the deal of a lifetime to offer you and your lucky company. The first new upscale, full-service hotel in nearly 15 years is going to be developed in the Houston Galleria area, opening in late 2015. You and your closest 100 competitors are getting an exclusive look at this rare opportunity.**
- **“Pricing guidance? Well, you know that Houston is the hottest market in the US right now, don’t you? And you’ve heard about how Houston’s RevPAR grew roughly 14% in 2013, making it the top growing major hotel market in the US for the year, right? Oh, and of COURSE you know about how stable and untouchable the energy sector is, right?”**
- **We think the very reasonable guidance is \$300k a key. Act fast, and if you want to pre-empt the entire deal process by offering north of \$300 a key, just let us know....”**

# WHAT'S IN A VIRTUAL DEAL ROOM?

## **Typical:**

- Capital Expenditure (Cap Ex) historical data / future plans
- PIP
- Franchise Agreement
- Management Contracts (if transferable)
- Financial Statements (P&Ls)
- STAR Reports
- Tax Bills
- Ground Leases, Equipment Leases

## **If Lucky:**

- Marketing Plans and Pace Reports
- Property Condition report (sometimes broker-ordered or from current owner's purchase of hotel years ago)
- Environmental Reports (Phase I Assessment; stale)

# WHAT IS NOT IN A DUE DILIGENCE ROOM?

- Exhaustive data on potential new supply
- Brand plans for the market
- Unfavorable local area economic data
- Grandfathered zoning conditions
- Information on pending litigation
- Other intangibles



# SUBJECT HOTEL RESEARCH: INITIAL SCREENING

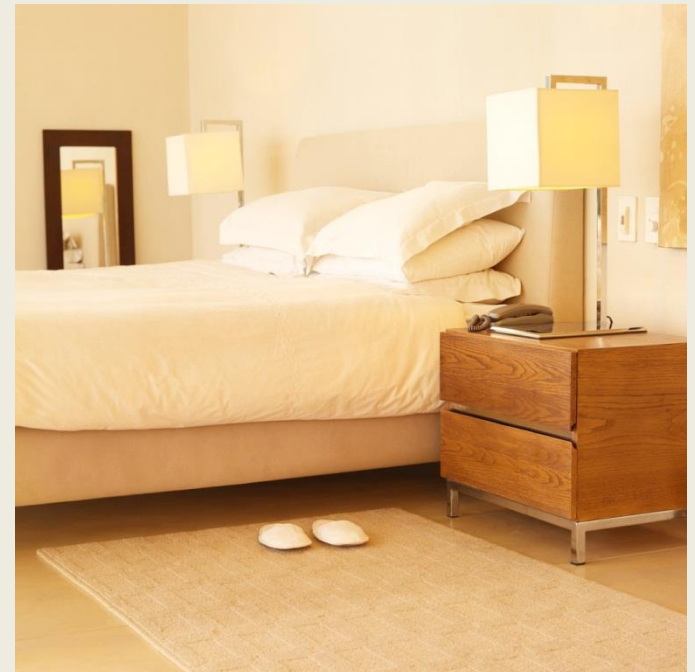
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## If it is an existing hotel:

- Occupancy and ADR performance, current trend
- Segmentation
- Group pace reports\*
- Reservations and turn-away reports\*
- Brand contribution information\*
- Brand Quality Assurance scores\*

## If it is a proposed hotel:

- Rely on competitive hotel performance for positioning



# STR REPORT

Occupancy (%)	2013								Year To Date		
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	2011	2012	2013
My Property	60.4	69.9	78.3	78.1	86.0	90.7	87.2	90.1	77.2	78.5	80.2
Competitive Set	49.60	58.10	80.12	82.43	83.93	93.39	89.62	90.17	71.10	73.22	78.59
Index (MPI)	121.9	120.3	97.8	94.7	102.5	97.1	97.3	99.9	108.5	107.2	102.0
<b>% Chg</b>											
My Property	16.0	13.6	2.7	-6.7	-1.1	-1.3	3.8	-0.8	4.5	1.7	2.2
Competitive Set	9.16	16.80	9.88	10.89	5.43	1.77	6.25	4.88	2.58	2.98	7.34
Index (MPI)	6.3	-2.8	-6.5	-15.9	-6.2	-3.1	-2.3	-5.4	1.9	-1.3	-4.8

ADR	2013								Year To Date		
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	2011	2012	2013
My Property	129.49	141.55	179.76	191.10	239.42	273.81	202.32	207.98	181.63	182.52	200.92
Competitive Set	128.63	134.83	165.15	178.45	222.54	255.82	196.09	195.88	177.55	184.36	191.47
Index (ARI)	100.7	105.0	108.8	107.1	107.6	107.0	103.2	106.2	102.3	99.0	104.9
<b>% Chg</b>											
My Property	-2.7	5.4	8.6	9.2	19.1	12.9	13.9	9.1	4.4	0.5	10.1
Competitive Set	-5.41	-1.67	0.13	3.02	8.63	8.28	6.64	4.04	5.30	3.83	3.86
Index (ARI)	2.9	7.2	8.5	6.0	9.7	4.3	6.8	4.9	-0.8	-3.2	6.0



# COMPETITION INITIAL SCREENING

## Figure out who competes and why

- Review hotel's STR report; see if competitive set makes sense
- Analyze STR census for the market to see what other hotels could potentially compete
- Tap into market knowledge (yours or someone smarter than you)
- Internet research, Google maps
- Understanding of segmentation (meeting space, F&B, etc)

# CASE STUDY: SUBJECT RESEARCH

- **Choose comp set from existing Galleria hotel inventory**
  - **31 hotels in STR's Galleria/Greenway Plaza Tract with 7,798 rooms**
  - **Choose competitive hotels based on several key attributes:**
    - **Brand / STR chain scale**
    - **Proximity**
    - **Comparable room count and facilities (select-service, full-service, meeting space, etc)**
  
- **Best candidates?**
  - **Hotel Derek (312 rooms), Hilton Houston Post Oak (448 rooms), Sheraton Suites Galleria (281 rooms), Embassy Suites Galleria (150 rooms), Omni Houston (378 rooms), Marriott Houston West Loop (301 rooms), Royal Sonesta Houston (485 rooms), DoubleTree Guest Suites Galleria (380 rooms)**

# NEW SUPPLY ASSESSMENT

How do you determine if the project will actually get done? Ask the following:

- Site owned or optioned
- Franchise approval
- Municipality approvals
- Financing in place
- Sponsorship
- STR database (or better yet, census number)



# CASE STUDY: SUPPLY ANALYSIS

- Analyze potential hotels under development – or the potential for new hotels to be developed
  - 3 hotels listed in Planning in STR’s Dec. 2013 Pipeline report
  - Online research reveals these projects are either uncertain or not competitive; decide not to include them as new supply
  - Huge wildcard: lack of zoning restrictions in Houston

Room Count	Project Name	Address	Chain Scale	Project Phase	Projected Opening Date	Date Entered Pre-Planning	Date Entered Planning	Date Entered Final Planning	Date Entered Construction	Date Entered Deferred	Date Entered Abandoned
250	Unnamed Hotel	2200 Post Oak	Independents	Planning			07/01/2011				
130	Holiday Inn Express & Suites Houston	3414 Sage Road	Upper Midscale Chains	Planning	08/04/2015	07/01/2011	05/22/2013	04/19/2013			
128	Staybridge Suites Houston Galleria	3414 Sage Road	Upscale Chains	Planning	08/04/2015		09/04/2012				
195	SpringHill Suites West Galleria Houston	Sage Road & Hidalgo Street	Upscale Chains	Abandoned		05/08/2012	06/18/2013			02/27/2013	09/23/2013

# DEMAND RESEARCH: INITIAL SCREENING

- Major employers
- Office space development and absorption
- Employment data/trends
- Economic diversity or lack thereof
- Major planned developments/city initiatives
- Visitor statistics
- Convention-related statistics
- Airport stats and expansion plans
- Traffic counts

# CASE STUDY: DEMAND ANALYSIS

## ■ Houston

- Economic highlights
- Hotel sector trends

## ■ Galleria

- Business environment and leasing activity
- Luxury residential development boom
- Modifications to the Galleria mall
- Hotel sector trends



- In-depth analysis: is there diversification of demand?

# FROM RESEARCH TO PROJECTIONS...

**Use your quantitative and qualitative research to create projections for:**

**1. Future supply growth**

- Typically for the next 1-3 years; further out projects too uncertain

**2. Market demand, which results in projected market occupancy**

**3. Market ADR**

**Can use major consulting firms' publications as reasonableness checks**





# CASE STUDY: MARKET PROJECTIONS

## SUPPLY AND DEMAND ANALYSIS

### PKF Hotel Horizons Houston Forecast (Dec '13 - Feb '14 Edition)

Occ	-0.3%	0.9%	-0.6%	-2.2%
ADR	6.1%	5.6%	5.6%	4.2%
RevPAR	5.8%	6.6%	5.0%	1.9%

	Actual 2009	Actual 2010	Actual 2011	Actual 2012	Actual 2013	Forecast 2014	Forecast 2015	Forecast 2016	Forecast 2017	Forecast 2018	Forecast 2019
<b>MARKET SUPPLY-KEYS</b>											
Inventory Start	980	1,044	1,132	1,132	1,132	1,132	1,132	1,214	1,457	1,457	1,457
Added/Deleted	64	88	-	-	-	-	82	243	-	-	-
Inventory Year End	1,044	1,132	1,132	1,132	1,132	1,132	1,214	1,457	1,457	1,457	1,457
% CHANGE	6.5%	8.5%	0.0%	0.0%	0.0%	0.0%	7.2%	20.0%	0.0%	0.0%	0.0%
<b>MARKET DEMAND</b>											
Room Nights	217,154	256,802	276,770	290,451	293,355	293,355	310,957	366,929	366,929	366,929	366,929
% CHANGE		18.3%	7.8%	4.9%	1.0%	0.0%	6.0%	18.0%	0.0%	0.0%	0.0%
<b>TOTAL MARKET</b>											
Occupancy	57.0%	62.2%	67.0%	70.3%	71.0%	71.0%	70.2%	69.0%	69.0%	69.0%	69.0%
% CHANGE		9.0%	7.8%	4.9%	1.0%	0.0%	-1.2%	-1.7%	0.0%	0.0%	0.0%
Average Rate	\$126.52	\$121.35	\$129.62	\$135.65	\$153.28	\$162.48	\$170.61	\$179.14	\$184.51	\$190.05	\$195.75
% CHANGE		-4.1%	6.8%	4.7%	13.0%	6.0%	5.0%	5.0%	3.0%	3.0%	3.0%
Revpar	\$72.12	\$75.42	\$86.83	\$95.36	\$108.83	\$115.36	\$119.73	\$123.60	\$127.31	\$131.13	\$135.06
% CHANGE		4.6%	15.1%	9.8%	14.1%	6.0%	3.8%	3.2%	3.0%	3.0%	3.0%

# SUBJECT PROPERTY PROJECTIONS

- Your projections should be based on:
  - Historical performance relative to market
  - Changes in attractiveness of location
  - Changes in supply
  - Any renovations or expansions
  - Rebranding or re-positioning
  - Change in management
- Test the reasonableness of your assumptions with a penetration analysis relative to the market



# CASE STUDY: SUBJECT PROPERTY PROJECTIONS

## SUPPLY AND DEMAND ANALYSIS

### PKF Hotel Horizons Houston Forecast (Dec '13 - Feb '14 Edition)

Occ	-0.3%	0.9%	-0.6%	-2.2%
ADR	6.1%	5.6%	5.6%	4.2%
RevPAR	5.8%	6.6%	5.0%	1.9%

	Actual 2009	Actual 2010	Actual 2011	Actual 2012	Actual 2013	Forecast 2014	Forecast 2015	Forecast 2016	Forecast 2017	Forecast 2018	Forecast 2019
<b>MARKET SUPPLY-KEYS</b>											
Inventory Start	980	1,044	1,132	1,132	1,132	1,132	1,132	1,214	1,457	1,457	1,457
Added/Deleted	64	88	-	-	-	-	82	243	-	-	-
Inventory Year End	1,044	1,132	1,132	1,132	1,132	1,132	1,214	1,457	1,457	1,457	1,457
% CHANGE	6.5%	8.5%	0.0%	0.0%	0.0%	0.0%	7.2%	20.0%	0.0%	0.0%	0.0%
<b>MARKET DEMAND</b>											
Room Nights	217,154	256,802	276,770	290,451	293,355	293,355	310,957	366,929	366,929	366,929	366,929
% CHANGE		18.3%	7.8%	4.9%	1.0%	0.0%	6.0%	18.0%	0.0%	0.0%	0.0%
<b>TOTAL MARKET</b>											
Occupancy	57.0%	62.2%	67.0%	70.3%	71.0%	71.0%	70.2%	69.0%	69.0%	69.0%	69.0%
% CHANGE		9.0%	7.8%	4.9%	1.0%	0.0%	-1.2%	-1.7%	0.0%	0.0%	0.0%
Average Rate	\$126.52	\$121.35	\$129.62	\$135.65	\$153.28	\$162.48	\$170.61	\$179.14	\$184.51	\$190.05	\$195.75
% CHANGE		-4.1%	6.8%	4.7%	13.0%	6.0%	5.0%	5.0%	3.0%	3.0%	3.0%
Revpar	\$72.12	\$75.42	\$86.83	\$95.36	\$108.83	\$115.36	\$119.73	\$123.60	\$127.31	\$131.13	\$135.06
% CHANGE		4.6%	15.1%	9.8%	14.1%	6.0%	3.8%	3.2%	3.0%	3.0%	3.0%

Proposed Full-Service Galleria Hotel					Positioning 2013	Positioning 2014	Forecast 2015	Forecast 2016	Forecast 2017	Forecast 2018	Forecast 2019
Occupancy							59.7%	65.5%	70.4%	70.4%	70.4%
<b>MARKET PENETRATION</b>							85.0%	95.0%	102.0%	102.0%	102.0%
Average Rate					\$ 175.00	\$ 185.50	\$ 196.63	\$ 206.46	\$ 212.66	\$ 219.04	\$ 225.61
<b>MARKET PENETRATION</b>					114.2%	114.2%	115.3%	115.3%	115.3%	115.3%	115.3%
Average Rate Growth							6.0%	6.0%	5.0%	3.0%	3.0%
Yield							\$117.30	\$135.33	\$149.66	\$154.15	\$158.77
<b>MARKET PENETRATION</b>							98.0%	109.5%	117.6%	117.6%	117.6%
RevPAR % Change								15.4%	10.6%	3.0%	3.0%

# CASH FLOW FORECAST

- If it is an existing hotel, input historical P&Ls
- Pull comparable data from similar hotels or industry benchmarks
- If proposed, rely solely on comparable data / benchmarks
- Apply occupancy and ADR forecasts generated from Supply & Demand Analysis
- Take into account fixed and variable expenses
- Consider if there is room for margin improvement with an anticipated change in management
- Benchmark operating margins to industry norm
- Take into account cost of goods, labor in the market
- Incorporate reserves for replacement
- Create a stabilized year projection from which all annual projections are generated (increasing by inflation)

# CASE STUDY: COMPARABLE OPERATING STATEMENTS

Year	2013 Hypothetical Marriott, TX				2012 Hypothetical DoubleTree, TX				2012 Hypothetical Sheraton, TX				2011 Hypothetical Hilton, TX				COMP AVERAGE			
Rooms Available Daily	300				375				200				450				1,325			
Rooms Available Annually	109,500				136,875				73,000				164,250				483,625			
Annual Rooms Occupied	78,840				109,500				47,450				123,188				358,978			
Occupancy Percentage	72.00%				80.00%				65.00%				75.00%				74.23%			
Average Daily Rate	\$139.52				\$143.38				\$158.06				\$138.00				\$142.63			
Revenue Per Available Room	\$100.46				\$114.70				\$102.74				\$103.50				\$105.87			
	\$	%	PAR	POR	\$	%	PAR	POR	\$	%	PAR	POR	\$	%	PAR	POR	\$	%	PAR	POR
<b>Revenues</b>																				
Rooms	\$11,000,000	66.57%	\$ 36,667	\$ 139.52	\$15,700,000	83.62%	\$ 41,867	\$ 143.38	\$ 7,500,000	83.33%	\$ 37,500	\$ 158.06	\$17,000,000	65.45%	\$ 37,778	\$ 138.00	\$51,200,000	72.86%	\$ 38,642	\$ 142.63
Food & Beverage	4,850,000	29.35%	16,167	61.52	2,000,000	10.65%	5,333	18.26	1,450,000	16.11%	7,250	30.56	7,000,000	26.95%	15,556	56.82	15,300,000	21.77%	11,547	42.62
Telephone	75,000	0.45%	250	0.95	160,000	0.85%	427	1.46	15,000	0.17%	75	0.32	250,000	0.96%	556	2.03	500,000	0.71%	377	1.39
Other	600,000	3.63%	2,000	7.61	915,000	4.87%	2,440	8.36	35,000	0.39%	175	0.74	1,725,000	6.64%	3,833	14.00	3,275,000	4.66%	2,472	9.12
<b>Total</b>	<b>\$16,525,000</b>	<b>100.00%</b>	<b>\$ 55,083</b>	<b>\$ 209.60</b>	<b>\$18,775,000</b>	<b>100.00%</b>	<b>\$ 50,067</b>	<b>\$ 171.46</b>	<b>\$ 9,000,000</b>	<b>100.00%</b>	<b>\$ 45,000</b>	<b>\$ 189.67</b>	<b>\$25,975,000</b>	<b>100.00%</b>	<b>\$ 57,722</b>	<b>\$ 210.86</b>	<b>\$70,275,000</b>	<b>100.00%</b>	<b>\$ 53,038</b>	<b>\$ 195.76</b>
<b>Departmental Expenses</b>																				
Rooms	\$ 2,500,000	22.73%	\$ 8,333	\$ 31.71	\$ 2,800,000	17.83%	\$ 7,467	\$ 25.57	\$ 1,600,000	21.33%	\$ 8,000	\$ 33.72	\$ 3,800,000	22.35%	\$ 8,444	\$ 30.85	\$10,700,000	15.23%	\$ 8,075	\$ 29.81
Food & Beverage	2,750,000	56.70%	9,167	34.88	1,400,000	70.00%	3,733	12.79	1,100,000	75.86%	5,500	23.18	4,200,000	60.00%	9,333	34.09	9,450,000	13.45%	7,132	26.32
Telephone	250,000	33.33%	833	3.17	160,000	100.00%	427	1.46	75,000	500.00%	375	1.58	250,000	100.00%	556	2.03	735,000	1.05%	555	2.05
Other	200,000	33.33%	667	2.54	370,000	40.44%	987	3.38	-	0.00%	-	-	865,000	50.14%	1,922	7.02	1,435,000	2.04%	1,083	4.00
<b>Total</b>	<b>\$ 5,700,000</b>	<b>34.49%</b>	<b>\$ 19,000</b>	<b>\$ 72.30</b>	<b>\$ 4,730,000</b>	<b>25.19%</b>	<b>\$ 12,613</b>	<b>\$ 43.20</b>	<b>\$ 2,775,000</b>	<b>30.83%</b>	<b>\$ 13,875</b>	<b>\$ 58.48</b>	<b>\$ 9,115,000</b>	<b>35.09%</b>	<b>\$ 20,256</b>	<b>\$ 73.99</b>	<b>\$22,320,000</b>	<b>31.76%</b>	<b>\$ 16,845</b>	<b>\$ 62.18</b>
<b>Gross Operating Income</b>	<b>\$10,825,000</b>	<b>65.51%</b>	<b>\$ 36,083</b>	<b>\$ 137.30</b>	<b>\$14,045,000</b>	<b>74.81%</b>	<b>\$ 37,453</b>	<b>\$ 128.26</b>	<b>\$ 6,225,000</b>	<b>69.17%</b>	<b>\$ 31,125</b>	<b>\$ 131.19</b>	<b>\$16,860,000</b>	<b>64.91%</b>	<b>\$ 37,467</b>	<b>\$ 136.86</b>	<b>\$47,955,000</b>	<b>68.24%</b>	<b>\$ 36,192</b>	<b>\$ 133.59</b>
<b>Undistributed Expenses</b>																				
Administration & General	\$ 1,200,000	7.26%	\$ 4,000	\$ 15.22	\$ 1,300,000	6.92%	\$ 3,467	\$ 11.87	\$ 850,000	9.44%	\$ 4,250	\$ 17.91	\$ 2,000,000	7.70%	\$ 4,444	\$ 16.24	\$ 5,350,000	7.61%	\$ 4,038	\$ 14.90
Marketing	1,000,000	6.05%	3,333	12.68	1,200,000	6.39%	3,200	10.96	430,000	4.78%	2,150	9.06	1,400,000	5.39%	3,111	11.36	4,030,000	5.73%	3,042	11.23
Franchise Fees (% Rooms)	915,500	8.32%	3,052	11.61	1,256,000	8.00%	3,349	11.47	150,000	2.00%	750	3.16	1,740,000	10.24%	3,867	14.12	4,061,500	7.93%	3,065	11.31
P.O.M.	800,000	4.84%	2,667	10.15	700,000	3.73%	1,867	6.39	400,000	4.44%	2,000	8.43	1,350,000	5.20%	3,000	10.96	3,250,000	4.62%	2,453	9.05
Energy	750,000	4.54%	2,500	9.51	950,000	5.06%	2,533	8.68	225,000	2.50%	1,125	4.74	1,400,000	5.39%	3,111	11.36	3,325,000	4.73%	2,509	9.26
<b>Total</b>	<b>\$ 4,665,500</b>	<b>28.23%</b>	<b>\$ 15,552</b>	<b>\$ 59.18</b>	<b>\$ 5,406,000</b>	<b>28.79%</b>	<b>\$ 14,416</b>	<b>\$ 49.37</b>	<b>\$ 2,055,000</b>	<b>22.83%</b>	<b>\$ 10,275</b>	<b>\$ 43.31</b>	<b>\$ 7,890,000</b>	<b>30.38%</b>	<b>\$ 17,533</b>	<b>\$ 64.05</b>	<b>\$20,016,500</b>	<b>28.48%</b>	<b>\$ 15,107</b>	<b>\$ 55.76</b>
<b>Gross Operating Profit</b>	<b>\$ 6,159,500</b>	<b>37.27%</b>	<b>\$ 20,532</b>	<b>\$ 78.13</b>	<b>\$ 8,639,000</b>	<b>46.01%</b>	<b>\$ 23,037</b>	<b>\$ 78.89</b>	<b>\$ 4,170,000</b>	<b>46.33%</b>	<b>\$ 20,850</b>	<b>\$ 87.88</b>	<b>\$ 8,970,000</b>	<b>34.53%</b>	<b>\$ 19,933</b>	<b>\$ 72.82</b>	<b>\$27,938,500</b>	<b>39.76%</b>	<b>\$ 21,086</b>	<b>\$ 77.83</b>
<b>Base Management Fees</b>	<b>\$ 413,125</b>	<b>2.50%</b>	<b>\$ 1,377</b>	<b>\$ 5.24</b>	<b>\$ 657,125</b>	<b>3.50%</b>	<b>\$ 1,752</b>	<b>\$ 6.00</b>	<b>\$ 270,000</b>	<b>3.00%</b>	<b>\$ 1,350</b>	<b>\$ 5.69</b>	<b>\$ 779,250</b>	<b>3.00%</b>	<b>\$ 1,732</b>	<b>\$ 6.33</b>	<b>\$ 2,119,500</b>	<b>3.02%</b>	<b>\$ 1,600</b>	<b>\$ 5.90</b>
<b>Income Before Fixed Charges</b>	<b>\$ 5,746,375</b>	<b>34.77%</b>	<b>\$ 19,155</b>	<b>\$ 72.89</b>	<b>\$ 7,981,875</b>	<b>42.51%</b>	<b>\$ 21,285</b>	<b>\$ 72.89</b>	<b>\$ 3,900,000</b>	<b>43.33%</b>	<b>\$ 19,500</b>	<b>\$ 82.19</b>	<b>\$ 8,190,750</b>	<b>31.53%</b>	<b>\$ 18,202</b>	<b>\$ 66.49</b>	<b>\$25,819,000</b>	<b>36.74%</b>	<b>\$ 19,486</b>	<b>\$ 71.92</b>
<b>Fixed Charges</b>																				
Insurance	\$ 250,000	1.51%	\$ 833	\$ 3.17	\$ 100,000	0.53%	\$ 267	\$ 0.91	\$ 110,000	1.22%	\$ 550	\$ 2.32	\$ 300,000	1.15%	\$ 667	\$ 2.44	\$ 760,000	1.08%	\$ 574	\$ 2.12
Property Taxes	825,000	4.99%	2,750	10.46	1,125,000	5.99%	3,000	10.27	500,000	5.56%	2,500	10.54	1,250,000	4.81%	2,778	10.15	3,700,000	5.27%	2,792	10.31
Reserve for Replacement	826,250	5.00%	2,754	10.48	751,000	4.00%	2,003	6.86	360,000	4.00%	1,800	7.59	1,039,000	4.00%	2,309	8.43	2,976,250	4.24%	2,246	8.29
Lease Payments	100,000	0.61%	333	1.27	10,000	0.05%	27	0.09	-	0.00%	-	-	15,000	0.06%	33	0.12	125,000	0.18%	94	0.35
<b>Total</b>	<b>2,001,250</b>	<b>12.11%</b>	<b>\$ 6,671</b>	<b>\$ 25.38</b>	<b>1,986,000</b>	<b>10.58%</b>	<b>\$ 5,296</b>	<b>\$ 18.14</b>	<b>970,000</b>	<b>10.78%</b>	<b>\$ 4,850</b>	<b>\$ 20.44</b>	<b>2,604,000</b>	<b>10.03%</b>	<b>\$ 5,787</b>	<b>\$ 21.14</b>	<b>7,561,250</b>	<b>10.76%</b>	<b>\$ 5,707</b>	<b>\$ 21.06</b>
<b>Net Operating Income Before IMF</b>	<b>\$ 3,745,125</b>	<b>22.66%</b>	<b>\$ 12,484</b>	<b>\$ 47.50</b>	<b>\$ 5,995,875</b>	<b>31.94%</b>	<b>\$ 15,989</b>	<b>\$ 54.76</b>	<b>\$ 2,930,000</b>	<b>32.56%</b>	<b>\$ 14,650</b>	<b>\$ 61.75</b>	<b>\$ 5,586,750</b>	<b>21.51%</b>	<b>\$ 12,415</b>	<b>\$ 45.35</b>	<b>\$18,257,750</b>	<b>25.98%</b>	<b>\$ 13,779</b>	<b>\$ 50.86</b>

# CASE STUDY: STABILIZED YEAR PROJECTIONS

	\$	%	PAR	POR
<b>Revenues</b>				
Rooms	15,773,688	77.14%	\$48,534	\$188.94
Food & Beverage	3,756,802	18.37%	\$11,559	<b>\$45.00</b>
Telephone	83,484	0.41%	\$257	<b>\$1.00</b>
Other	834,845	4.08%	\$2,569	<b>\$10.00</b>
Total	20,448,820	100.00%	\$62,919	\$244.94
<b>Departmental Expenses</b>				
Rooms	2,713,246	17.20%	\$8,348	<b>\$32.50</b>
Food & Beverage	2,441,922	<b>65.00%</b>	\$7,514	\$29.25
Telephone	250,453	<b>300.00%</b>	\$771	\$3.00
Other	333,938	<b>40.00%</b>	\$1,028	\$4.00
Total	5,739,559	28.07%	\$17,660	\$68.75
<b>GOI</b>	14,709,260	71.93%	\$45,259	\$176.19
<b>Undistributed Expenses</b>				
Administration & General	1,332,500	6.52%	<b>\$4,100</b>	\$15.96
Marketing	1,040,000	5.09%	<b>\$3,200</b>	\$12.46
Franchise Fees (% Rooms)	946,421	<b>6.00%</b>	\$2,912	\$11.34
F&B Royalty (% F&B)	112,704	<b>3.00%</b>	\$347	\$1.35
Property Operations & Maintenance	650,000	3.18%	<b>\$2,000</b>	\$7.79
Energy	812,500	3.97%	<b>\$2,500</b>	\$9.73
Total	4,894,125	23.93%	\$15,059	\$58.62
<b>GOP</b>	9,815,135	48.00%	\$30,200	\$117.57
<b>Base Management Fees</b>	613,465	<b>3.00%</b>	\$1,888	\$7.35
<b>Income Before Fixed Charges</b>	9,201,670	45.00%	\$28,313	\$110.22
<b>Fixed Charges</b>				
Insurance	<b>225,000</b>	1.10%	\$692	\$2.70
Property Taxes	<b>1,100,000</b>	5.38%	\$3,385	\$13.18
Reserve for Replacement	1,022,441	<b>5.00%</b>	\$3,146	\$12.25
Lease Payments	<b>10,000</b>	0.05%	\$31	\$0.12
Total	2,357,441	11.53%	\$7,254	\$28.24
<b>NOI Before Incentive</b>	6,844,230	33.47%	\$21,059	\$81.98

Year - Dollars	2013
Rooms	325
Rooms Available	118,625
Room Nights	83,484
Occupancy %	70.4%
ADR	<b>\$188.94</b>
RevPAR	\$132.97

# VALUATION

1. Take NOI from cash flows
  2. Apply a targeted discount rate for 10 years or solve for a desired IRR
  3. Assume a sale in Year 11 (reversion)
  4. Apply cap rate
  5. Solve for value
- Compare to sales of hotels in the region
  - Compare to new construction costs





# CASE STUDY: REVERSION

<b>Reversion Analysis</b>	
<b>2025 NOI (Year 11 Cash Flow)</b>	<b>\$ 9,758,235</b>
<b>Terminal Cap Rate</b>	<b>8.50%</b>
<b>Reversion Value (Sales Price)</b>	<b>\$ 114,802,762</b>
<b>RE Commission &amp; Title Policy Expense</b>	<b>2.00%</b>
<b>Less: Selling Expenses</b>	<b>\$ (2,296,055)</b>
<b>Sales Proceeds</b>	<b>\$ 112,506,706</b>

# CASE STUDY: IRR ANALYSIS

- Target an 11% IRR
  - Figure out how much you are willing to pay to get your desired return

Internal Rate of Return			
Date	Cash Flow	Cost / Proceeds	Total
10/1/2015		\$ (87,893,750)	\$ (87,893,750)
12/31/2015	\$ 1,282,105		\$ 1,282,105
12/31/2016	\$ 6,577,914		\$ 6,577,914
12/31/2017	\$ 7,703,241		\$ 7,703,241
12/31/2018	\$ 7,934,338		\$ 7,934,338
12/31/2019	\$ 8,172,368		\$ 8,172,368
12/31/2020	\$ 8,417,539		\$ 8,417,539
12/31/2021	\$ 8,670,065		\$ 8,670,065
12/31/2022	\$ 8,930,167		\$ 8,930,167
12/31/2023	\$ 9,198,072		\$ 9,198,072
12/31/2024	\$ 9,474,014	\$ 112,506,706	\$ 121,980,721
	<b>IRR</b>	<b>11.0%</b>	

# FIELDWORK AND IN-DEPTH DUE DILIGENCE

## 1. Tour the hotel

- Condition, efficiency of layout, room for improvement

## 2. Tour the neighborhood

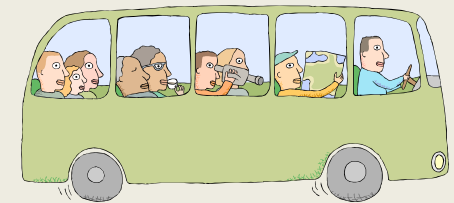
- Access, safety, amenities, desirability vs. other neighborhoods

## 3. Tour the competitive set

- Interviews, lobby watching; SWOT analysis

## 4. Interview management

- Competency and market knowledge
- If retaining (or on the fence) test for openness to new ideas



# FIELDWORK AND IN-DEPTH DUE DILIGENCE, CONT'D

## 5. Obtain and review PIP

- List of “warts”
- Can sometimes negotiate waivers or extensions
- Have to price the PIP yourself

## 6. Review franchise agreement

- Check if survives sale or has any termination fees
- Make note of fees, term, and any area of protection (AOP)

## 7. Review management agreement, if applicable

- Check if survives a sale
- Look for right of first refusal/offer clauses (ROFR/ROFO)
- If survives a sale, see remaining term, fee structure (base and incentive), performance tests, and early termination penalties



# FIELDWORK AND IN-DEPTH DUE DILIGENCE, CONT'D

- 8. Start to drill down into legal issues**
  - Order title report, survey, etc.
  - Review all tenant leases, equipment leases, condo agreements, easements, ground leases, etc.
- 9. May retain 3<sup>rd</sup> party consultants**
  - Order Property Condition Reports, environmental reports, appraisals (may be required by lender), zoning reports
- 10. Talk to alternate brands and/or management, if applicable**
- 11. Refine cash flows, valuation**
- 12. Submit Letter of Intent (LOI)**

# BEST & FINAL, OFFICIAL DUE DILIGENCE PERIOD

If they like you, the brokers will invite you to the Best & Final Round of bidding

- See if you can move your number to be more competitive
- Submit revised LOI

If you are the lucky winner, an official due diligence period commences during which you....

- Negotiate Purchase and Sale Agreement (PSA)
- Thoroughly review all 3<sup>rd</sup> party consultant reports
- Complete all document review and get comfortable with all legal issues
- Fine tune calculations
- Engage in negotiations and “re-trades”; “go back for a bite”



# “GOING HARD”, CLOSING

- At end of due diligence, put down a non-refundable deposit (aka “go hard” on the deal)
- Close on the deal, typically after a pre-determined number of days or after loan transfers or originations





# CASE STUDY: SHOULD WE BUY IT??

## Acquisition Assumptions

			Per Room
Purchase Price		\$85,750,000	\$ 263,846
Capital Expenditures		\$0	\$ -
Closing Costs	2.5%	<u>\$2,143,750</u>	
Total Acquisition Price		\$87,893,750	\$ 270,442

Broker's sales price: \$97,500,000 or \$300,000 per room

Can you adjust the numbers to come up with the additional \$11,750,000?  
Have you considered all possible sources of revenue?

???

# LEGAL DUE DILIGENCE: ZONING ISSUES

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FOCUSING ON LEGAL, SAFETY & SECURITY SOLUTIONS  
FEBRUARY 10th - 12th, 2014

- Does the building conform?
- How difficult to change the zoning?
- May it be rebuilt to the same density?
- Is grandfathered parking adequate from a market standpoint?
- Are grandfathered life safety or ADA issues acceptable to brands?
- Ramifications of historical preservation

# UNIQUE LEGAL DUE DILIGENCE ISSUES FOR PROPOSED HOTEL DEALS

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## If hotel is proposed, understand additional legal risks:

- How much money is at stake at each stage? Who bears the development risk up until the hotel opens?
- What happens if there are any construction issues after completion? Who is responsible per the terms of the PSA?
- How much say does the buyer have in overseeing construction?
- Whose name are all the permits, certificates, and licenses issued under? How does this affect the ability to transfer interests upon sale?
- How long do the reps and warranties from the seller last following the sale?

**THE END....**

**Thank you!**

**Questions?**

**Rachel Roginsky**

**rroginsky@pinnacle-advisory.com**

**Karen Johnson**

**kjohnson@pinnacle-advisory.com**

**Emily Smith**

**esmith@rljlodgingtrust.com**