SOME THOUGHTS ON PROFITS AND CAP RATES

MEET THE MONEY 2016

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MUCH TO THINK ABOUT

WHY BE HAPPY?

MARTY COLLINS IS HERE

WHY BE CONCERNED?

MARTY COLLINS IS HERE
## MUCH TO THINK ABOUT

### WHY BE HAPPY?

- High Occupancy Levels
- Inflation & Interest Rates Are Low
- Wages Increasing
- Profits Continue to Grow

### WHY BE CONCERNED?

- Supply Growth Accelerating
- Inflation & Interest Rates Going Up?
- Wages Increasing
- Expense Growth Accelerating
Profit trends

- Results – 2016 trends® in the hotel industry survey
### 2016 TRENDS® IN THE HOTEL INDUSTRY

**Percent Change from 2014 to 2015**

<table>
<thead>
<tr>
<th>Property Type</th>
<th>RevPAR</th>
<th>Total RevPAR</th>
<th>Expenses*</th>
<th>GOP*</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Hotels</td>
<td>4.6</td>
<td>5.3</td>
<td>4.7</td>
<td>6.3</td>
</tr>
<tr>
<td>Full-Service</td>
<td>4.5</td>
<td>4.8</td>
<td>4.1</td>
<td>6.0</td>
</tr>
<tr>
<td>Limited-Service</td>
<td>4.8</td>
<td>4.9</td>
<td>5.1</td>
<td>4.7</td>
</tr>
<tr>
<td>Suite with F&amp;B</td>
<td>7.4</td>
<td>6.7</td>
<td>5.2</td>
<td>9.0</td>
</tr>
<tr>
<td>Suite without F&amp;B (extended-stay)</td>
<td>6.1</td>
<td>5.8</td>
<td>4.8</td>
<td>6.9</td>
</tr>
<tr>
<td>Convention</td>
<td>4.3</td>
<td>5.2</td>
<td>4.5</td>
<td>6.4</td>
</tr>
<tr>
<td>Resort</td>
<td>3.3</td>
<td>6.4</td>
<td>6.0</td>
<td>7.1</td>
</tr>
</tbody>
</table>

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 2014 to 2015 – Revenues

- Rooms: 4.6%
- Food and Beverage: 6.6%
- Other Operated Departments: 1.3%
- Miscellaneous Income: 25.4%

Source: 2016 Trends® in the Hotel Industry
2016 TRENDS® IN THE HOTEL INDUSTRY

Annual Change 2014 to 2015 – Select Expenses

Source: 2016 Trends® in the Hotel Industry
2016 TRENDS® IN THE HOTEL INDUSTRY

Annual Change in Expenses*

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 (Nominal) in NOI*

Note: * Before deduction for Reserve. After deductions for Management Fees, Property Taxes, and Insurance
Source: 2016 Trends® in the Hotel Industry
The Outlook for Cap Rates

• Results – 2016 trends® in the hotel industry survey
HOTEL CAP RATE FORECASTING MODEL
Market Return, Risk, and Income Growth (from Gordon Growth Model)

Data
- RERC Survey/ RCA Trans.

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

Contribution*:
- 31%
- 27%
- 36%

*2005-2015

*other variables such as debt/GDP ratio are used which contribute <5% in predictive power
THE CONTRIBUTION OF EACH VARIABLE CHANGES OVER TIME

Variable contribution to cap rate, before, during, and after the Great Recession

Sources: CBRE Hotels, Moody's Analytics Q1 2016.
CAP RATE FORECASTING METHOD AND DATA SOURCES

- Three sources for predict 10-year Treasuries yield forecasts
  - Moody’s Analytics Forecast
  - CBRE Econometric Advisors Forecast
  - Market Expectations
- Two sources for Moody’s Baa bond yield forecasts
  - Moody’s Analytics Forecast
  - Mean Reversion Forecast
- CBRE Hotels’ Americas Research = source for NOI

Sources: CBRE Econometric Advisors, CBRE Hotels, Moody’s Analytics. Q1 2016.
RISING INTEREST RATES AND RISK SPREADS

Baa Bonds and 10-Year Treasury

Percent


Forecast

Mean Reversion

Market Expectations

Risk Spread Long Run Average = 1.4%

Sources; CBRE Hotels, Moody's Analytics. Q1 2016.
RISING RATES AND HOTEL RISK
Hotel Cap Rates and Baa Bonds

Sources: CBRE Hotels, Moody’s Analytics. Q1 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>1.96</td>
<td>1.29</td>
<td>4.51</td>
<td>7.89</td>
</tr>
<tr>
<td>2017F</td>
<td>2.13</td>
<td>1.37</td>
<td>4.62</td>
<td>8.12</td>
</tr>
<tr>
<td>2018F</td>
<td>2.25</td>
<td>1.37</td>
<td>4.65</td>
<td>8.27</td>
</tr>
</tbody>
</table>

Source: CBRE Hotels | Americas Research, US Treasury, RERC, RCA

Forward market view: treasuries will rise slowly

Market risk reverts to the mean

Cap rates will remain below the LRA
HOTEL RISK PREMIUM VS. 10-YEAR WILL REMAIN BETWEEN 5-5.5% OVER THE NEXT TWO YEARS

CAP RATES ELEVATED UP BY RISING TREASURY RATES

Pace of increase depends on how quickly risk-free rates rise

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