TR Mandigo & Company

2011 Chicago Hotel Industry Update

Presented to: Chicago CBD Hotel Manages

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They say it's always a good idea to lead off a speech with a joke, so here goes:

A man walks into a bar and says to the bartender " I'm going to build a development at the old post office with 6 million square feet of retail, 2 million square feet of office space, 12,000 free parking spaces, 1,500 residential units and 7,500 hotel rooms"

To put that in perspective, that would be a 20% increase in the amount of hotel rooms in the City itself. Thankfully, we live in reality instead where that project isn't going anywhere as it is.

So here's the bottom line: We're recovering. Slowly. And while we're better off than we have been, it's not GREAT. Like everything else this year, it seems like we're holding our collective breath for some sign that things are going to either get dramatically better or worse.

And in a way, that's the wrong attitude. We've survived the worst of it, but we need to start treating what we have now as the new normal, even if it does get better down the road. We still have a lot of hotels who either haven't been meeting debt service, or whose terms are soon up.

We're not quite overgrown, but we do have a huge supply of 30 year old plus gigantic convention hotels that, while renovated fairly regularly, are still huge and fairly old, with all the issues associated with aging. Since the early part of the last decade, we've seen a lot of growth in "boutique hotels", which is really a fairly meaningless term. For all the talk about design and concept, in the end they work because they're generally smaller, fairly upscale hotels, which are easy to fit into the market. We like them, we really do, and it's just that the term basically boils down to a slightly younger or edgier sense of style than a typical conservative brand. To put a fine point on it, between 2001 and now, we've had a variance of between 128 and 141 hotels downtown. The most dramatic change occurred between 2008 and 2009, with the addition of 9 hotels, though these represented less than 2000 extra rooms. The JW opening last winter had an impact of about 1/3rd of that as a single hotel. By the end of this year, we will have added only around 13% to the rooms supply over a decade.

We always try to compare Chicago to other cities, like New York or Miami or Vegas, but it's really not fair for a number of reasons.

We've got a mid 70's ceiling for occupancy city wide because we're a highly seasonal market, and we've built our supply to accommodate maximum demand in the spring and fall which is way beyond what we can accomplish the rest of the year. Because of that, we're really never going to be an 80 percent market like New York. They've survived the last recession much better than we did, but, with as bad as it FELT over the last few years, it could have been worse.

If you look at the last 12 years, we've bounced between 66 and 75 percent occupancy. As bad as it got, we only dipped 8 or 9 points, but subtracting the supply increase from 2008 and 2009, the net drop in occupancy was only about 3 points, which is stretching for a silver lining, we know. In fact, from a long term perspective, this has all happened before. About 6 times now in fact, since the 1960's. And if you're looking for trends, it's that downtown Chicago has always recovered within about 3 years, and it's always done so off of the back of the suburbs.

The reason we never really CRASHED downtown, either now or 20 years ago, is because when times are desperate enough, Chicago has always been able to lure suburban customers downtown with lower prices. If you look at the entire metro area with its 108,000 rooms, Chicago only has about 1/3 of that total in the downtown market. Now not all of the travelers to the region really NEED to be downtown, but given a choice between staying downtown or in the suburbs, a lot of demand can be induced to stay downtown if it's the same rate. Especially since there is a real lack of regional public transit to suburban hotel clusters aside from O'Hare.

We took the chart of performance for Downtown Chicago over the last 50 years, which we try to show off every year, and adjusted the dollars in it for inflation. What it showed was very interesting.

In 1960 dollars, hotel rates over the last 50 years have only seen a net gain of $1.34 to $15.29, or about a 10% increase for a substantially more sophisticated product. Even more surprising, inflation adjusted dollars showed that the mid to late 1980's was the most expensive period of time for hotels in the Chicago market.

While there are a ton of conclusions to draw from this, I'll only point out a few. Major suburban hotels started taking off during the late 1970's and really hit their stride during the 80's, and while rate growth seems consistent without accounting for inflation, with inflation, it clearly shows a pattern of deep discounting occurring during each recession since the 1980's. I would suggest that because we have a built in overflow market, downtown hotels have always resorted to cutting rates to stop the bleeding.

By the same token, the fact that we don't have any major physical barriers between the suburbs and downtown, aside from rush hour traffic, means that if Chicago gets too pricey, people can and will travel to the suburbs for cheaper rates. As we've grown, not just downtown but in the suburbs as well, rates have compressed as well due to this pressure.

In addition, we know that Chicago lives and dies by its seasonal convention business, and it's gotten harder to compete in that market. Conventions, in general are becoming smaller, more regional events between higher-level people with the intent of making decisions at the events. Rather than only worrying about Vegas and Orlando, we also have to compete against other smaller cities which are subsidizing large convention centers; Indianapolis, for example has only been managing to capture 1/2 to 1/3 of their budgeted events volume. Our own suburbs have added 5 major convention hotels in the last 5 years. These municipalities are desperate to fill them.

It's going to take some SERIOUS effort to compete in an environment like this. The McCormick work rules are making our city unappealing, but conventions in GENERAL are changing, and they're not going to get bigger.

We almost lost the restaurant show. We have gained the G8 Summit next year, and while that should boost May numbers, we lost some of the collar meetings associated with the NRA show, and there are considerable costs to running the G8 which may offset some of the positive impact it would have. If there are protests, the boost could evaporate altogether. At any rate, we've lost a number of major conventions over the past decade. McCormick 1 stands nearly empty for most of the year. Work rules, subcontracts NEED to be fixed or nobody will take us seriously. Of course, a part of it is the associations themselves which are a huge problem. But that's not in our control. One thing they HAVE demanded is more rooms next to McCormick, which would mean that associations and exhibitors could stay close by to run the shows, something that they have in most other cities. Attendees, of course, would continue staying downtown.

The proposal to solve this problem as it stands is a 421 room addition at the Hyatt McCormick Place. It seems like it's going to be necessary, if impractical.

Other new projects include:

The Langham Hotel in the IBM tower.

It's been about 4 different hotel projects until now. Langham is an international SMALL luxury chain. Everyone and their brother has tried to come in to this market with 4-5 star properties, and this is very similar. We're getting a little top heavy. It's supposed to be opening in spring 2012 (though likely later in the year). It's a bit of an anomaly for the brand because they're trying to use a section of a sky rise, and their brand is based on classic 1920's hotels.

Raddison Blu

334 more rooms next to the cluster of hotels in the Illinois Center near the Fairmont. It'll be a mix of hotel services for condo rooms, and has received good marks for architectural design. For a few years it was in limbo, and it's been delayed a few times and rebranded, though it looks like it's almost certainly going to open up next year, for sure.

Ambassador East

Ian Schrager has tried for years to get into the Chicago market, and he's finally managed to do so. Aside from the "Willis Tower" style blunder that renaming the Pump Room would have been, it should be well received . He's spending around $28k per key on a fairly old hotel with small-ish rooms, so it's really more a matter of new furniture, wallpaper and carpets than the complete rehab it seemed like. At any rate, it's really not any NEW rooms in the market.

POST OFFICE

Yeah right.

Staybridge Suites

It'll be in litigation for a while, and it needs to be sorted out. It'll probably become exactly what it was designed as, a MID PRICED semi-extended stay hotel, which will probably be more welcomed than the high end stuff that keeps coming in.

Parkview/Hotel Lincoln

The old hotel Lincoln has supposedly been bought by Joie De Vivre, and would be repositioned as a Joie De Viivre . Timeframe is currently unknown, though there's not much supply in that particular area anymore, so impact should be somewhat muted.

FINALLY, THE PROJECTIONS

All of the projections and future growth scenarios for Chicago put out by other groups so far have painted a scenario of moderate recovery, but the statistics on which these are based are a bit misleading. We MAY see 7% or higher RevPAR growth by the end of this year, but as we cautioned last year, that's based off of a fairly WEAK 2010. We're still not out of the hole and won't be for another year and a half and even when we do get out of it, keep in mind that our new peak ADR may not be as good as it once was when we factor in inflation.

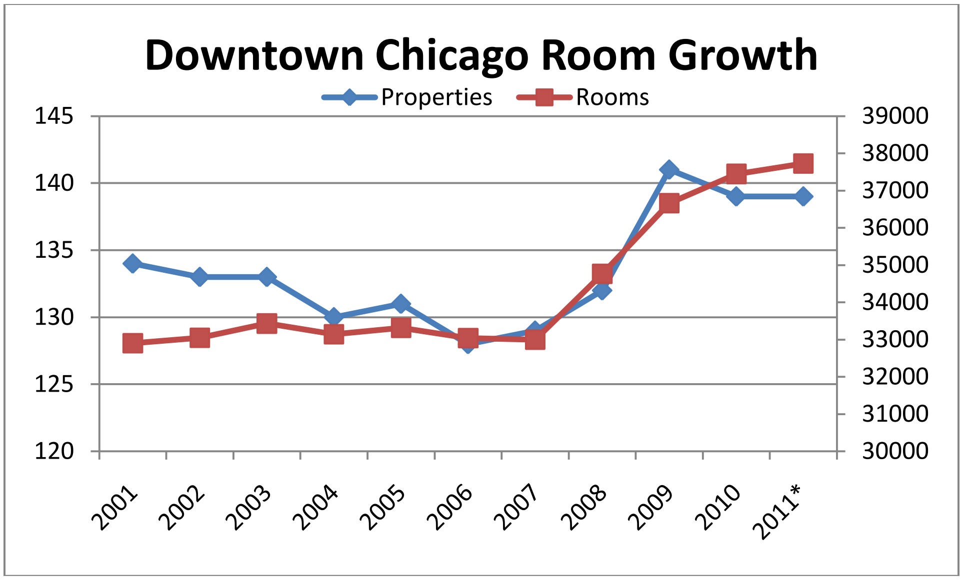
The Year to Date statistics halfway through the year DO show some strong numbers, but the 6.7% ADR growth that we've seen was heavily influenced by a VERY STRONG ONE TIME 13.2% increase in May. Likewise, the occupancy growth at 3.8% YTD is heavily influenced by a 12% growth in March over the prior year. So, adjusting for these fairly anomalous months, our projections for 2011 are a modest 2.75% growth in occupancy to around 71% and a 5 and a half percent increase in ADR to $179 due to soft fall convention business and continued rate pressure because of OTCs and other factors. Our numbers are a little weaker than other houses right now, and a lot of that is based on the fact that we're in a tenuous recovery situation with growth that's inconsistent month by month.

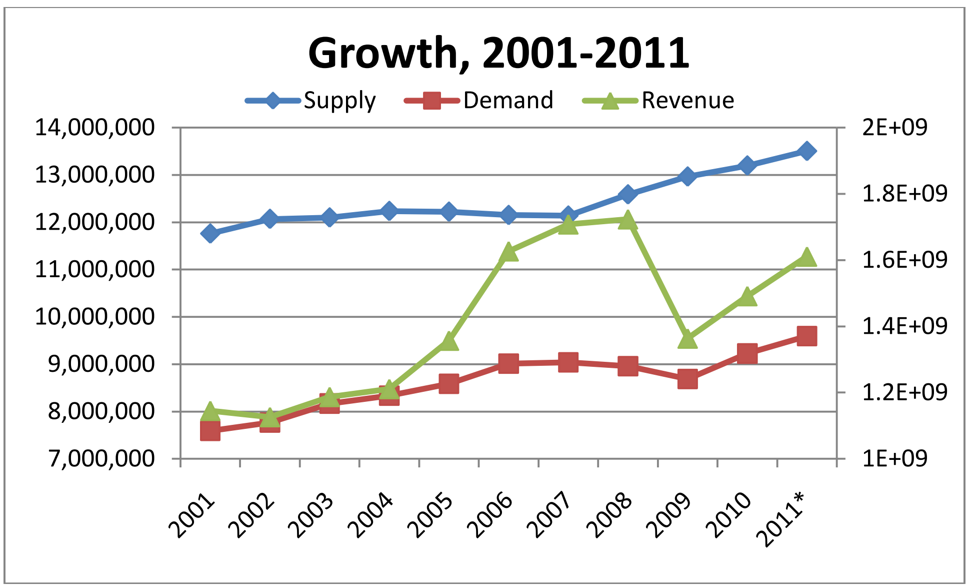
Looking at our history from the first part of this year, it's clear that we're at a point where we've got incredibly short lead times on bookings, and we still don't know how to deal with it. The rates go all over the board because while we all know that we need to be able to manage revenue closely, we can't do it very effectively with these lead times. Basically, Revenue Management is less strategic than it is tactical, and it means that we can't PLAN long term as well as we could when we had less technology. In an effort to make sure we're selling as many rooms as possible to as many different customer channels as possible, we're missing the forest for the trees. The daily rate changes that we're able to enact are SO inconstant that it's giving us whiplash. That's a big chunk of what's prohibiting rate growth.

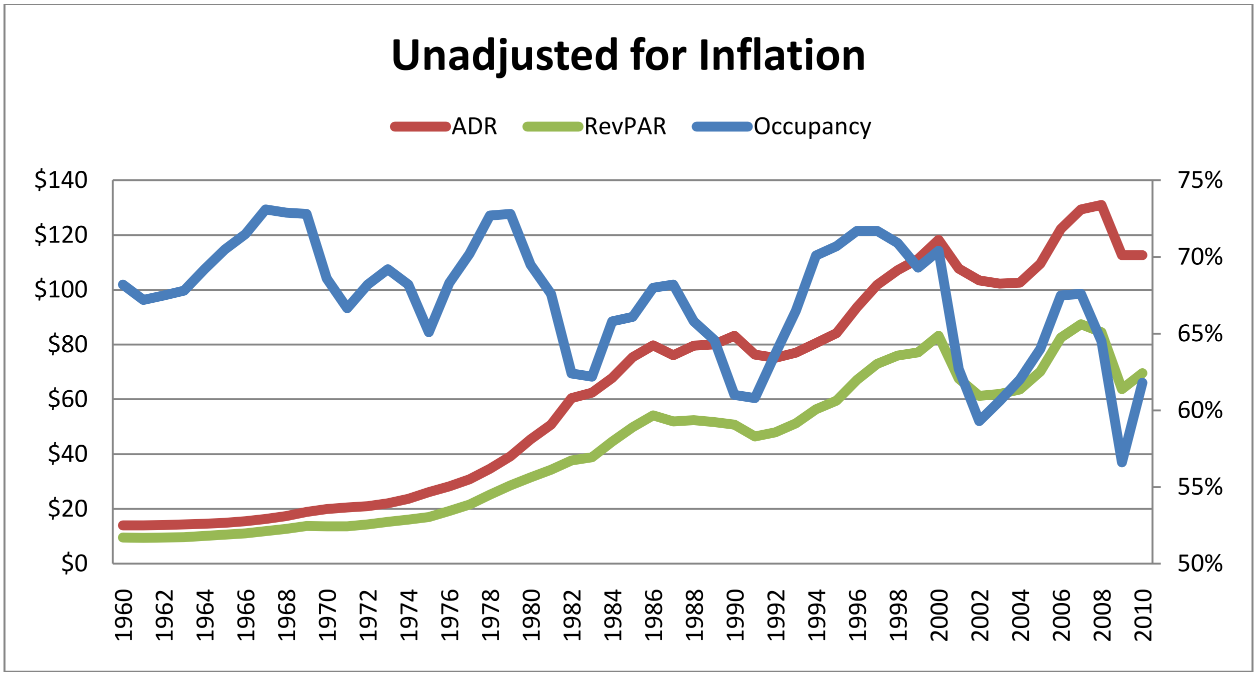
As an industry, it’s time to stop complaining about what OTCs and short lead times have done to the bottom line and start learning how to adapt to a situation we’re all going to have to live with in the future.

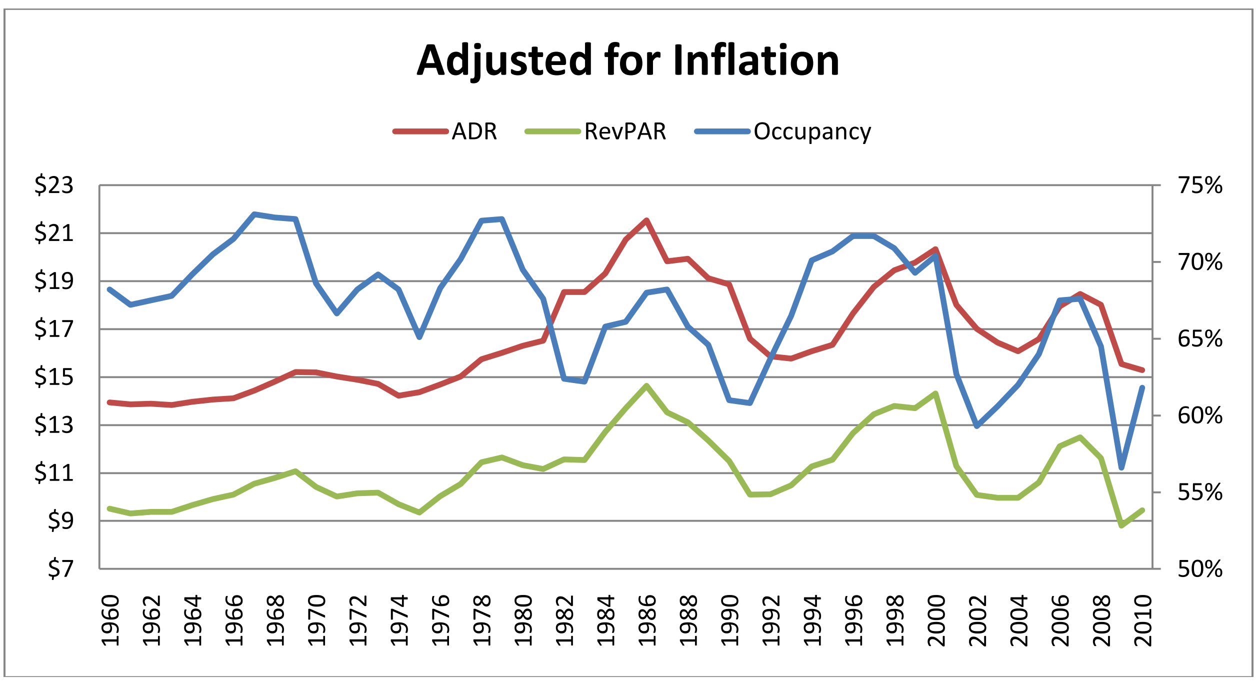
We're expecting to get to 71% this year, and it's modest growth to get to around 74% by 2013 assuming that no new projects somehow get online fast enough to go from the planning phase to opening in the next two years. That shouldn't really happen, but it's important to keep in mind that throughout the recession, there have been over 20 or so projects we could name off the tops of our heads that have been shelved or put on the back burner until conditions improve. We've already seen a fair amount of movement in the marketplace for acquisitions of existing hotels, both for troubled hotels, but more significantly, for strong performers, which have been bought for fairly HIGH prices based on their upside potential.

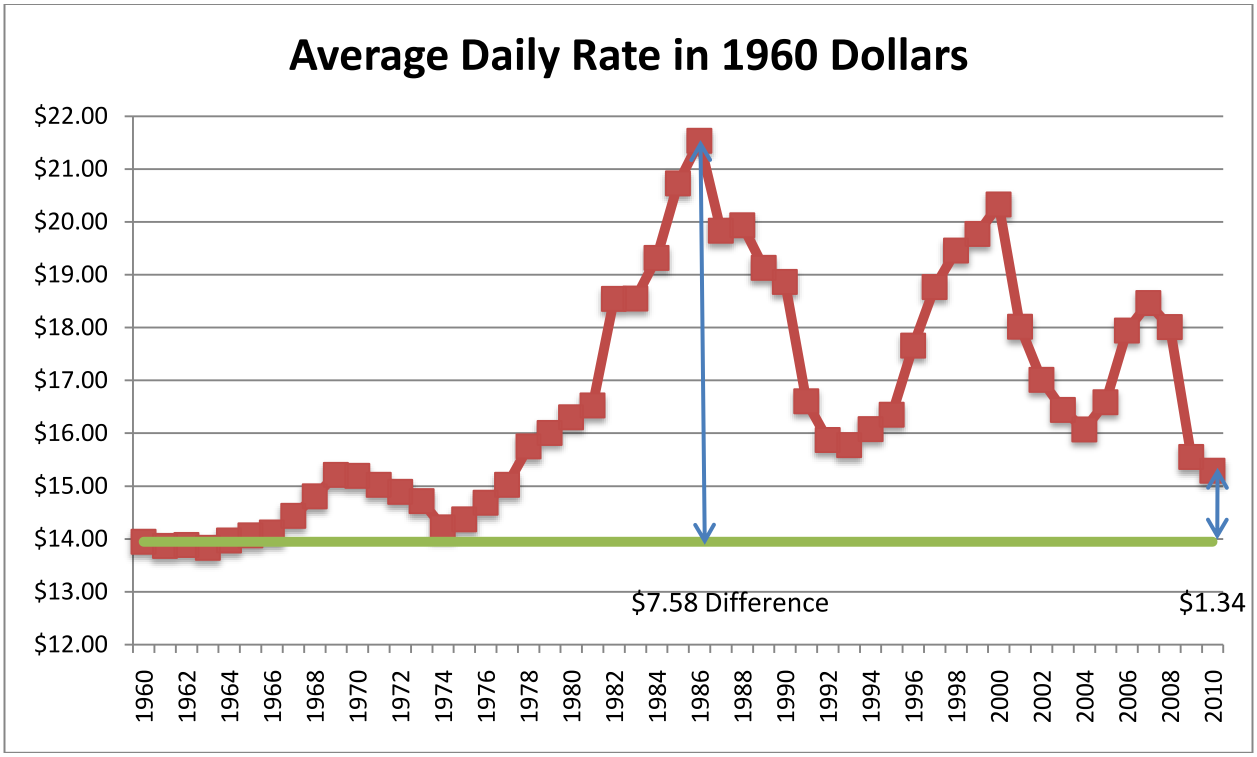
If this trend keeps up and credit markets eventually thaw, and we're seeing preliminary signs, it will lead to a period in which new construction becomes attractive again. When and if that happens, expect to see a flurry of new hotel projects get started. Because of that, we're limiting the growth in occupancy that we're forecasting in the future to around 74%. In addition, when rates increase because of our higher occupancy, suburban hotels will be able to poach hotel rooms from downtown once more.

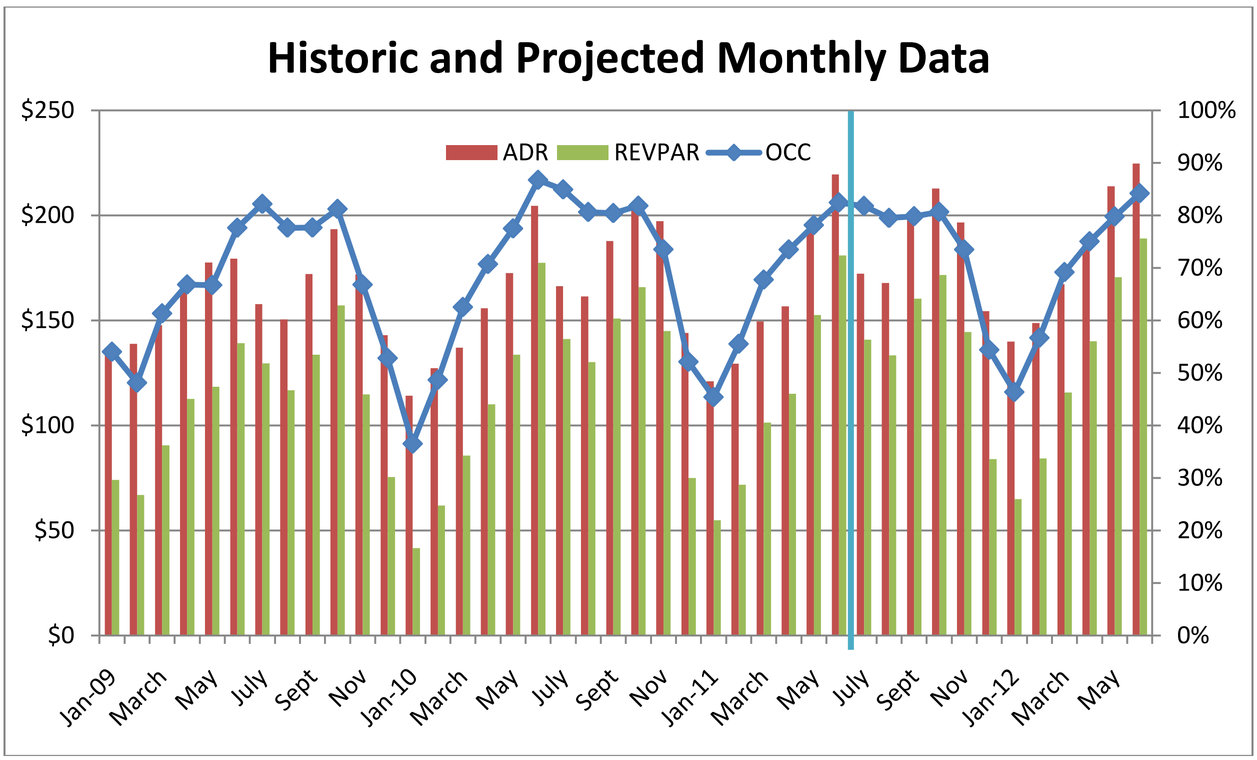

Downtown Chicago Room Growth
Properties
Rooms
145
140
135
130
125
120
39000
38000
37000
36000
35000
34000
33000
32000
31000
30000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011*


Growth, 2001-2011
Supply
Demand
Revenue
14,000,000
13,000,000
12,000,000
11,000,000
10,000,000
9,000,000
8,000,000
7,000,000
2E+09
1.8E+09
1.6E+09
1.4E+09
1.2E+09
1E+09
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011*


Unadjusted for Inflation
ADR
RevPAR
Occupancy
$140
$120
$100
$80
$60
$40
$20
$0
75%
70%
65%
60%
55%
50%
1960 1962 1964 1966 1968 1970 1972 1974 1976 1978 1980 1982 1984 1986 1988 1990 1992 1994 1996 1998 2000 2002 2004 2006 2008 2010


Adjusted for Inflation
ADR
RevPAR
Occupancy
$23
$21
$19
$17
$15
$13
$11
$9
$7
75%
70%
65%
60%
55%
50%
1960 1962 1964 1966 1968 1970 1972 1974 1976 1978 1980 1982 1984 1986 1988 1990 1992 1994 1996 1998 2000 2002 2004 2006 2008 2010


Average Daily Rate in 1960 Dollars
$22.00
$21.00
$20.00
$19.00
$18.00
$17.00
$16.00
$15.00
$14.00
$13.00
$12.00
$7.58 Difference
$1.34
1960
1962
1964
1966
1968
1970
1972
1974
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008
2010

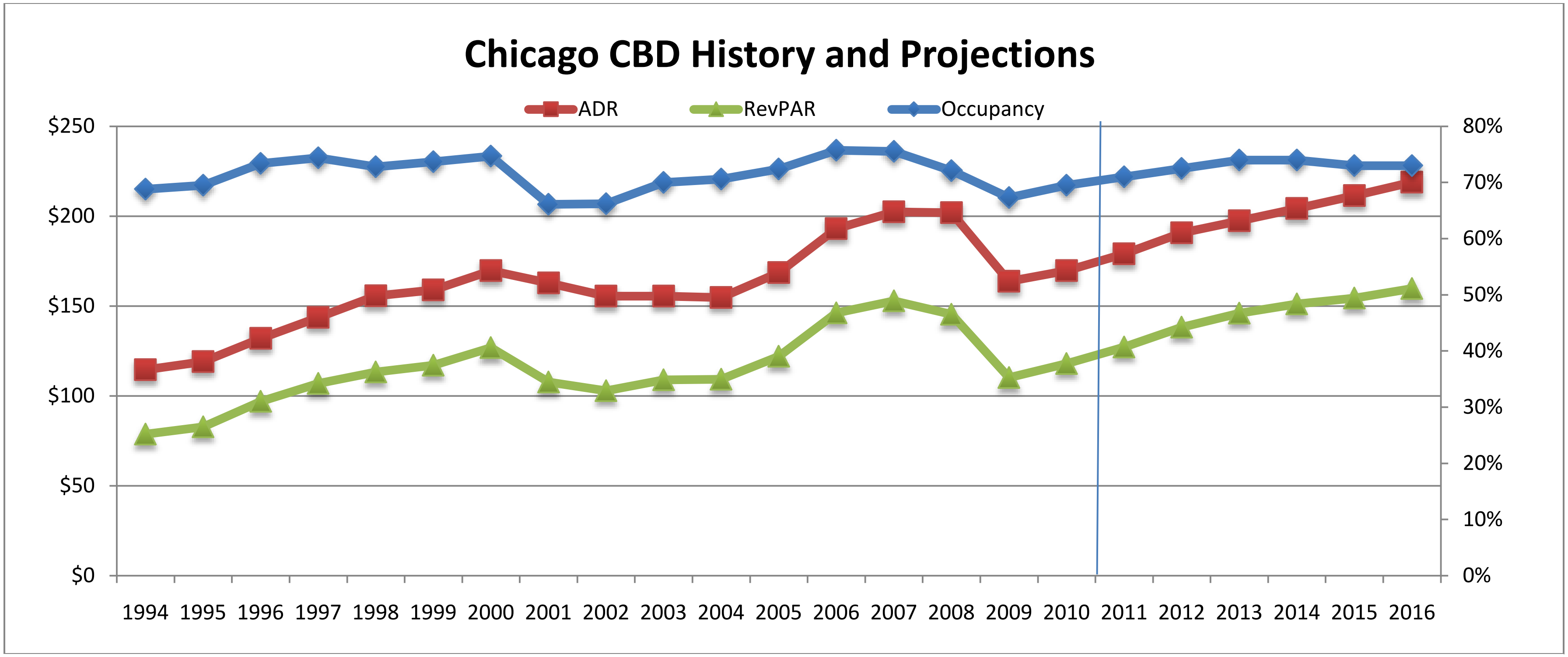

Historic and Projected Monthly Data
ADR
REVPAR
OCC
$250
$200
$150
$100
$50
$0
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
Jan-09
March
May
July
Sept
Nov
Jan-10
March
May
July
Sept
Nov
Jan-11
March
May
July
Sept
Nov
Jan-12
March
May

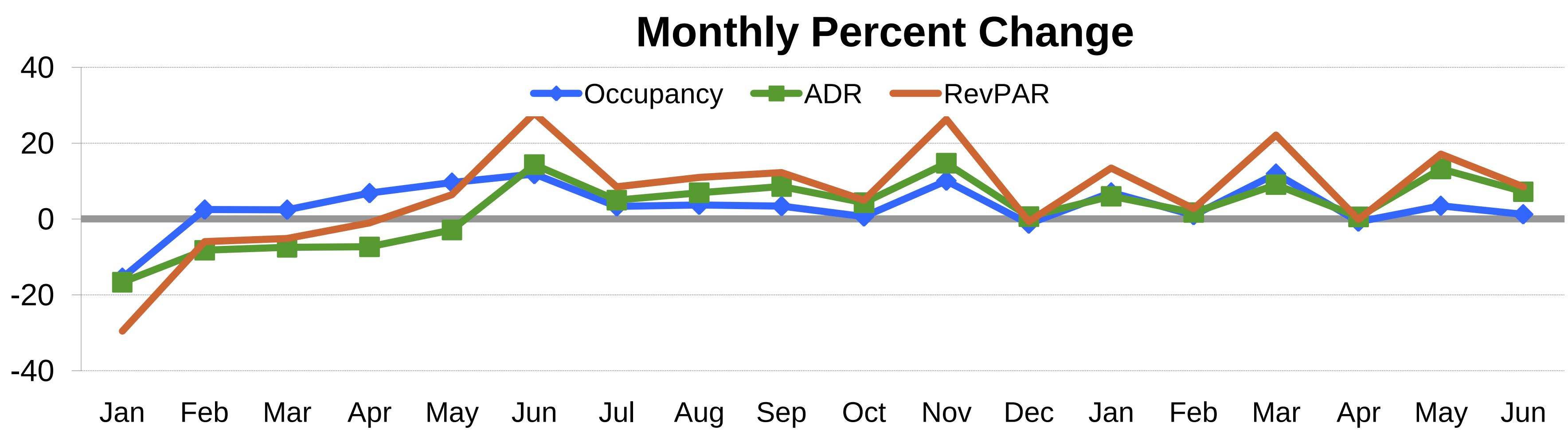
Projected Occupancy CBD

Month	2009	2010	2011	2012	2013	2014	2015	2016
January	54.00%	36.50%	45.38%	46.33%	47.29%	47.29%	46.65%	46.65%
February	48.10%	48.65%	55.49%	56.67%	57.84%	57.84%	57.06%	57.06%
March	61.30%	62.51%	67.72%	69.16%	70.59%	70.59%	69.63%	69.63%
April	66.80%	70.69%	73.46%	75.01%	76.57%	76.57%	75.53%	75.53%
May	66.70%	77.47%	78.11%	79.76%	81.41%	81.41%	80.31%	80.31%
June	77.60%	86.71%	82.43%	84.17%	85.91%	85.91%	84.75%	84.75%
July	82.15%	84.90%	81.76%	83.48%	85.21%	85.21%	84.06%	84.06%
August	77.63%	80.60%	79.47%	81.15%	82.83%	82.83%	81.71%	81.71%
September	77.64%	80.40%	79.80%	81.49%	83.17%	83.17%	82.05%	82.05%
October	81.19%	81.80%	80.63%	82.34%	84.04%	84.04%	82.90%	82.90%
November	66.78%	73.50%	73.46%	75.01%	76.57%	76.57%	75.53%	75.53%
December	52.78%	52.10%	54.37%	55.52%	56.67%	56.67%	55.90%	55.90%
Annual	67.30%	69.50%	71.00%	72.50%	74.00%	74.00%	73.00%	73.00%

Projected ADR CBD

Month	2009	2010	2011	2012	2013	2014	2015	2016
January	$137.05	$114.10	$121.02	$139.93	$144.83	$149.90	$155.14	$160.57
February	$138.90	$127.20	$129.40	$148.76	$153.97	$159.36	$164.94	$170.71
March	$147.73	$137.06	$149.54	$167.20	$173.05	$179.11	$185.38	$191.86
April	$168.69	$155.72	$156.69	$186.71	$193.24	$200.00	$207.00	$214.25
May	$177.58	$172.48	$195.36	$213.75	$221.23	$228.97	$236.98	$245.28
June	$179.39	$204.58	$219.48	$224.58	$232.44	$240.58	$249.00	$257.71
July	$157.76	$166.26	$172.21	$183.40	$189.82	$196.47	$203.34	$210.46
August	$150.43	$161.38	$167.87	$178.78	$185.03	$191.51	$198.21	$205.15
September	$172.11	$187.70	$200.86	$213.91	$221.40	$229.15	$237.17	$245.47
October	$193.46	$202.74	$212.83	$226.66	$234.59	$242.80	$251.30	$260.10
November	$171.88	$197.23	$196.60	$209.38	$216.71	$224.29	$232.14	$240.27
December	$142.96	$143.95	$154.41	$164.45	$170.20	$176.16	$182.32	$188.71
Annual	$163.79	$169.72	$179.05	$190.69	$197.37	$204.28	$211.42	$218.82





Monthly Percent Change *From STR GLOBAL*