



Karen L. Johnson
Warnick + Company

Chicago:

1200 Shermer Road
Suite 214
Northbrook, IL 60062
T: (847) 562-2610
F: (847) 562-2611

Los Angeles:

1800 Century Park East
Suite 600
Los Angeles, CA 90067
T: (310) 229-5798
F: (310) 943-2385

Los Angeles:

4801 Wilshire Boulevard
Suite 220
Los Angeles, CA 90010
T: (323) 965-7207
F: (323) 965-7275

New York:

70 East 55th Street
8th Floor
New York, NY 10022
T: (212) 588-8890
F: (212) 588-8896

Phoenix:

2398 East Camelback Road
Suite 1150
Phoenix, AZ 85016
T: (602) 955-9393
F: (602) 955-9494

www.warnickco.com

Bill Marriott's C-SPAN interview on April 10th confirmed what other asset managers and even the Vegas casino operators have been sensing: the worst weeks may be behind us. Market conditions are still grim, but meeting planners no longer seem as paralyzed and leisure travelers are taking advantage of deals. They too must believe that the 22 percent improvement the Dow Jones Average logged over the past five weeks was more than a temporary rally.

There is still plenty of pain ahead of us but anecdotal evidence in the March beige book suggests that the wider economy may have found bottom. Whether the hotel industry bottoms out or continues to decline will depend on how quickly the current panic subsides. But first, a status report of recent indicators

The Good News

- + The Dow finished the week ended April 10 up 22 percent from its February low
- + New unemployment claims for week ended April 4th fell 3.0 percent from the prior week
- + February home sales velocity increased 5.1 percent nationally, driven by the hardest hit markets
- + Wells Fargo's home builder sentiment index rose 55.6 percent between March and April
- + Six mortgage servicers will receive \$9.9 billion to modify residential mortgages
- + Final seasonal adjustments indicate January and February retail sales were stronger than expected; tax refunds may spur April spending
- + Consumer confidence levels aren't getting any worse
- + Consumer revolving debt fell by 3.5 percent (annualized) in February; household austerity may be achieving lower or no balance targets
- + February durable goods manufacturing orders increased 3.4 percent; inventories of unsold product are falling and exports rose for the first time in seven months
- + The default rate on commercialized mortgages may have doubled since September, but is still only 1.8 percent
- + March new car sales were the best since September 2008
- + Airline executives reported optimism on the summer travel season on April 1st
- + The USTA's traveler sentiment index increased 15.3 percent in February over the October survey
- + Las Vegas casino hotel operators report improving demand and fewer cancellations in March and April as compared to January and February

The Bad News

- The Dow can stumble two to three percent with unexpected bad news
- Official unemployment hit 8.5 percent in March; if the real ("U-6") rate is above 15 percent
- The national median home sales price fell 15.5 percent from March of the previous year
- Commercial bankruptcy filings in Q1 were 52.4 percent above last year and March was up 23 percent over February; the pace is accelerating
- Credit being offered by TARP recipients dropped 2.2 percent in February over January
- March retail sales declined 1.1 percent; a late Easter is blamed
- Consumer confidence surveys are still coming in at or near all time lows
- The decline in revolving consumer debt may have been caused by banks revoking credit lines and raising interest rates and fees
- Two-thirds of CEOs surveyed by Business Roundtable expect declines in their sales, capital spending, and employment in the next six months
- Deutsche Bank estimates that half of the traditional commercial mortgages coming due by 2012 are upside down
- March new car sales were still 36 percent below March 2008
- US carriers' domestic ticket sales were down 23.1 percent in March and 24.75 percent year to date
- USTA survey respondents cited "affordability of travel" as a major factor in improved sentiment
- High fixed costs and too much leverage have pushed virtually all of the major casino companies to the brink of bankruptcy

None of the positives indicates that a recovery is underway; but rather, that bad situations have finally stopped getting worse. Mortally wounded companies will continue to succumb. Plant closures, staff reductions, and bankruptcies may still drive the official unemployment up to 10 percent before it starts to decline. The unemployment “ripple effect” will be felt in the retail and non-essential consumption sectors through at least 2010.

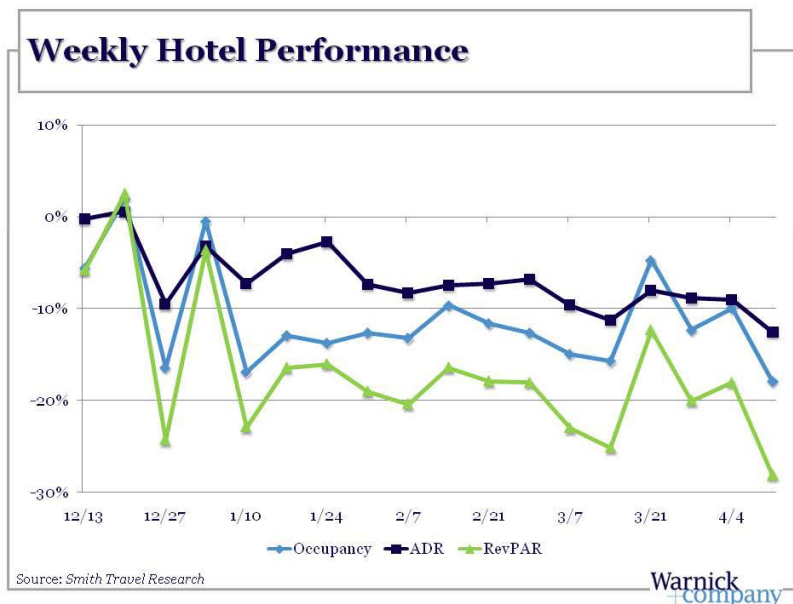
But, an April 10th headline in The Wall Street Journal pronounced that that “Economists See a Rebound in September”; right under the article “Signs Point to Stabilizing Economy.” Hallelujah.

When Will Hotels Bottom Out?

If hoteliers can stop the panicky discounting, the period of December 27, 2008 to March 28, 2009 could establish the worst weeks for the US hotel industry.

Over the four months Warnick + Company studied, the average occupancy decline was 11.1 percent. On average, the average daily rate (“ADR”) decline was 6.8 percent, resulting in revenue per available room (“RevPAR”) decline of 16.9 percent.

The worst four consecutive-week periods was the four weeks spanned the last two weeks of February and ended on March 14, when the average RevPAR decline was 21.0 percent. While the most recent week saw the greatest decline, this was affected by the late Easter Holiday. The average rate of decline for the four weeks ended April 11 (which would include Easter for both periods) was 19.6 percent. The bad news is that this is only 1.4 percentage points ahead of the worst four-week period. The good news is that it is no worse. We seem to be bumping along the bottom.



Opaque Channels Aren’t Opaque

It is axiomatic that when supply increases, or demand falls, price suffers. For this go around, however, technology has poured accelerant on the rate of decline. Message-board sites have sprung up on which individual travelers, bargain hunters, can solicit leads on how to get the lowest rates and brag about finds. The sites are free and it takes all of three or four minutes to sign up. A two-minute series of clicks allows a prospective guest to search for information on a specific brand in a specific city, even a specific hotel. Below is a portion of page one results for a search for a particular brand in San Francisco from one such site.

<p>San Francisco, Fishermans Wharf , 5/1-7, 3.5* ABC hotel @\$85 per night Utilized permutation bidding. Started at \$65 and increased by \$5 with each bid. Obtained the 3.5 XYZ hotel for \$85/night on the 5th bid. Used A-B link. Thanks for the information on how to use permutation bidding!</p>
<p>3.5* XYZ hotel at Fishermans Wharf 2 rooms \$84 04/30 to 05/02 (topic) Hotel website rate \$225.00 per room per night Used 7 bids with permutation method of bidding starting at 68.00 with increments to \$84.00 which was accepted. Room Total 336.00 (2 room for 2 nights) Taxes & fees 62.18 TOTAL \$398.18 USED AB LINK ...</p>
<p>4* SFO EFG Hotel 3/23 \$52 (topic) Used the link for priceline at amazing-bargains.com to access priceline.com to support this board One night, nice hotel, thank you to fellow posters, Sheryl and team for your help! 4* EFG website \$135.20 4* XYZ website \$194</p>
<p>San Francisco, Fisherman's Wharf, 5/1-7, 3.5* (reply) The current web rates: Fisherman's Wharf XYZ hotel \$211.50/night weekend, 224.10/night weekday EFG hotel Fisherman's Wharf – average nightly rate \$153.86 HIJ hotel Fisherman's Wharf - \$152 LMN hotel Fisherman's Wharf - \$229</p>
<p>4* EFG hotel SFO 3/11 \$55 (topic) first bid accepted. With taxes and fee, it's about \$70 Usually get the XYZ hotel at this level/price, so it will be nice to stay somewhere else.</p>
<p>3.5* EFG hotel Fisherman's Wharf \$65 3/10-12 (topic) I bid 55, 58, 62, and finally accepted at \$65. I was hoping to get XYZ hotel, but oh well... Used the a-b link.</p>

3.5* XYZ hotel Fisherman's Wharf 4/8-4/12 \$65 (topic)
 Used a-b.com. Started bidding for 55\$ for Fisherman's Wharf only, which was rejected, added Lombard with a bid of 60\$, which was again rejected. The following day my bid for 65\$ was accepted.

4* MNO hotel Union Square 3/13-3/15 \$72 (reply)
 ... Notice the taxes and fees at MNO hotel site are .40 cents lower than taxes and fees on the TUV hotel reservation. Usually get the ABC hotel. either HIJ hotel and others. Looking forward to checking out MNO hotel. Will post a review if anything is out of the ...

Frequent travelers are using the sites, as evidenced by enumeration of previous stays in San Francisco in the last postings. Meeting planners know about these sites too. If we are not careful, our best customers will become the most mercenary.

These levels of discounting establish frightening ideas of what these properties are worth.

Perhaps the saddest thing about the rates above is that the hotels discussed are only getting a portion of the rates granted. The commission structures on opaque sites can be 20 percent, so the \$65 rates in the bottom-most posts probably net the hotels in question \$50. San Francisco is a union town with very stringent work rules and the hotels involved are union hotels. The net \$50 rates are a money losing proposition.

Stop the Mindless Discounting

So, it appears that some hotels are offering rates that are below incremental cost. This is a tax on General Managers who can't calculate their true incremental room cost. Their Revenue Managers are focused on RevPAR indexes, reader-board reports, and Hotelligence reports – all top-line tools. Many Revenue Managers do not see the P&Ls and have no real understanding of incremental cost, let alone what the correct dollar amount is.

Incremental cost is more than maid's labor and cleaning supplies. It extends to franchise fees, systems fees, credit card commissions, accounting fees, management fees, and reserves for replacement. Competitive pressure is undeniable, but selling rooms at less than the true incremental cost is a recipe for disaster.

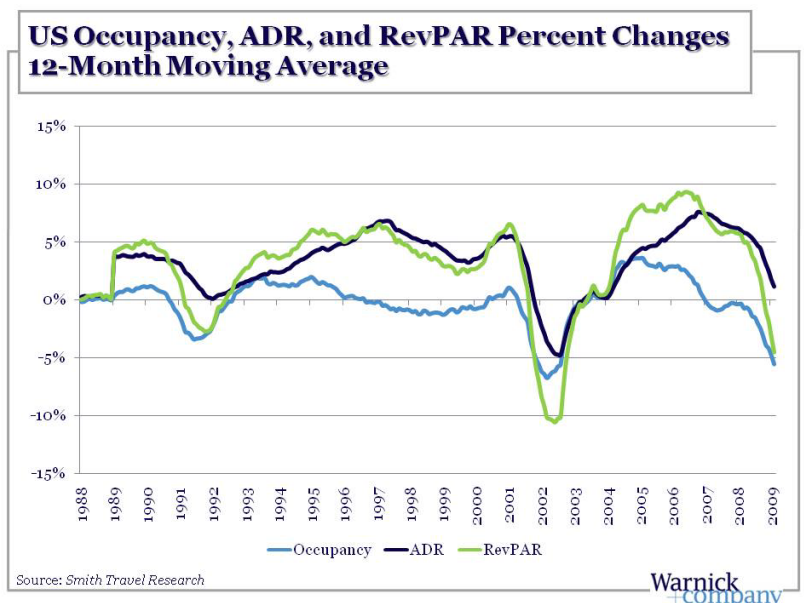
Owners and asset managers need to make sure that General Managers calculate and communicate the incremental cost to yield managers. General Managers must also convince the yield managers that the hotel loses money each time it sells a room below that price and bargain hunters have poor ancillary spend.

How Long?

The hotel industry may be in the same position as the auto industry, i.e., our numbers are not down by as much as last month, but are still down a double-digit percentage from the same month of the previous year.

In the supply-exacerbated recession of 1991, the trailing 12-month RevPAR decline bottomed out at a now mild -2.6 percent in November 1991. Though demand showed negative growth for three quarters, ADR did not move materially into negative territory in most markets (New York City was a notable exception). At the 30,000-foot level, the decline in RevPAR was a function of occupancy declines.

After the cataclysmic event of 9/11, the US hotel industry saw five quarters of demand shrinkage paired with five quarters of ADR shrinkage. The rate of trailing-12 RevPAR decline hit rock bottom in June 2002 at 10.6 percent.



The latter recession stretched the negative RevPAR growth from three quarters to five. The low water mark in trailing 12 declines (10.6 percent) was two and a half times that of the earlier recession. The deltas are getting bigger and it's probably because hoteliers have not made sure the Internet is their friend.

The hotel industry is just now entering our third quarter of negative demand and negative ADR growth. The race to discount indicates that the 12-month moving average will reach a lower perigee, perhaps in the 12 to 15 percent RevPAR decline category.

Whether we languish for five quarters, as in the 2001/02 recession, or whether we extend its length as well as its depth will depend on how well we educate our Revenue Managers and how carefully they monitor weekly transient pickup for any sign of improvement. Group sales managers will need to be careful to not underbid late 2010 dates, or they will be locking their properties into this year's rock bottom pricing.

In some markets, corporate travel agencies are now asking for increased rate reductions off their 2009 contracts and extensions to two- and three-year terms. The more intrepid marketing and sales management will agree to the short-term pain, but will decline to lock flat, rock-bottom rates in for future years.

Between 1988 and 2008 RevPAR growth in the United States was barely equal to inflation, even as higher construction costs (which doubled) drove us to constructing a higher ratio of upscale product. Owners, asset managers, and operators need to take steps today to ensure that we do not prolong the agony or the rock-bottom rates will permanently impair the asset values.

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About Warnick + Company

Warnick + Company is a strategic advisory firm that creates opportunities and value-enhancing solutions in lodging and recreational real estate for our clients worldwide. We are in the knowledge business, and the hospitality industry is our passion.

Our multi-disciplinary expertise, real-world perspective, and hands-on experience generate insights that deliver high-impact results. We provide trusted, partner-level attention and a tailored, comprehensive approach to meet your individual objectives.

We have unwavering dedication to your best interests. You can rely on us to uncover the underlying issues, provide candid answers, and craft strategic solutions that achieve maximum benefit and competitive advantage.