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*Appendix 3:
Hotel Technical Memorandum*

MEMORANDUM

To: Nancy Williams
City of Alexandria Dept. of Planning & Zoning

From: Dick Paik, W-ZHA, LLC
Sarah Woodworth, W-ZHA, LLC

Date: February 10, 2011

Re: Waterfront Hotel Development

This memorandum presents findings regarding the long-term feasibility of lodging development on the core area waterfront in Old Town Alexandria.

KEY DEFINITIONS

“ADR” means “average daily rate.”

“RevPAR” means “revenue per available room,” which is calculated by multiplying the achieved room rate by the average occupancy rate among available rooms.

“Old Town Core” describes the lodging submarket comprising 7 properties located along King Street: Embassy Suites, Hampton Inn, Hilton Inn, Lorien, Hotel Monaco, Morrison House, and Residence Inn.

“East Alexandria” is not a recognized phrase, but shall be used herein to describe the lodging market that includes Old Town and extends north and southwest from the Old Town core to 1st Street on the North to Telegraph Road on the southwest. In addition to those properties included in the “Old Town Core,” this submarket includes: Crowne Plaza, Holiday Inn & Suites, Sheraton Suites, Westin, Residence Inn Carlyle, Holiday Inn and Courtyard.

I. REGIONAL MARKET CONTEXT

- The Washington DC lodging market is one of the nation’s most resilient. According to Jones Lang LaSalle Hotels, the DC market was one of just seven in the nation to achieve RevPAR



growth during 2008. In addition, as shown in the table below, in comparison with other major metropolitan area markets, the DC market has sustained comparatively minor losses since 2007.

TABLE 1

Recent RevPAR Change in Major Metropolitan Area Markets					
	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>'07-09 Change</u>	<u>'08-09 Change</u>
Boston	\$103.77	\$102.14	\$85.58	-17.5%	-16.2%
Chicago	\$87.54	\$83.47	\$63.75	-27.2%	-23.6%
New York	\$224.93	\$225.24	\$166.11	-26.2%	-26.3%
San Francisco	\$111.35	\$117.54	\$95.59	-14.2%	-18.7%
Washington	\$102.44	\$102.73	\$94.04	-8.2%	-8.5%

Source: Smith Travel Research; Hotel & Leisure Advisors

- On a macro level, lodging growth bears a strong correlation to overall economic growth, as measured by GDP (GMP for metropolitan areas). Given the positive growth projected for the Washington region, RevPAR is likely to resume growth as the national and regional economies recover from the recent recession.

TABLE 2

Washington DC Metropolitan Area Economic Trends and Forecasts

	<u>2006</u>	<u>2010</u>	<u>4-yr. CAGR</u>	<u>2014</u>	<u>4-yr. CAGR*</u>
Gross Metro Product (\$b)	\$224.9	\$254.7	3.2%	\$290.6	3.4%
Total Employment (000s)	2,390.6	2,380.7	-0.1%	2,579.3	2.0%

* "CAGR" = compounded annual growth rate

Source: Moody's economy.com

II. ALEXANDRIA MARKET PATTERNS AND DYNAMICS

- **Market Support:** The Alexandria lodging market derives much of its support from (1) government- or government-related business travelers visiting federal government offices in the region; and (2) leisure travelers visiting destinations in DC, among others. According to recent data prepared by TNS TravelsAmerica for the Alexandria Convention & Visitors Association, “leisure-” and “business-related” travelers account for the main bulk of paid lodging nights in Alexandria; the leisure segment accounts for a slightly larger portion.¹ Among business travelers, government-related business travelers are cited as an important subset; this category provides a stable market base, with per diem allowances generally targeting regional mid-range rates.
- **Alexandria’s Competitive Position:** Old Town Alexandria’s historic ambience and retail presence gives it an advantage for many travelers. While Arlington Metro station areas are closer to Washington DC, Old Town Alexandria offers a strong competitive location for travelers targeting DC destinations.
- **Overall Alexandria Market Performance:** As shown in the table below, in recent years the overall Alexandria market has achieved higher occupancies than the overall DC regional market. At the same time, the DC regional market has achieved higher ADRs and RevPAR figures. This pattern suggests that Alexandria does not contain as many higher-end properties as the DC regional market. This is borne out by the finding, according to Hotel & Leisure Advisors, that while Alexandria contains 7.7 percent of regional market supply, it contains just 5 percent of the regional “upper-priced” room supply.

¹ The report does not break out “group” or “meetings” as separate guest segments, but rather defines both leisure and business travelers to include both transient as well as “group.” Business and leisure segments as referenced here exclude “personal business” and “other” categories (e.g., medical, academic, etc.).

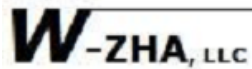


TABLE 3

Lodging Performances: Selected Submarkets, 2005-2009

	<u>Occupancy</u>	<u>ADR</u>	<u>RevPAR</u>	<u>Supply</u>	<u>Demand</u>	<u>Revenues</u>
<u>2005</u>						
Old Town Core	81.3%	\$163.47	\$132.91	403,690	328,217	\$53,654,708
East Alexandria	77.4%	\$146.29	\$113.26	788,035	610,112	\$89,254,766
Alexandria	75.4%	\$129.41	\$97.58	1,500,515	1,131,518	\$146,425,167
DC Metro	71.3%	\$131.51	\$93.79	n/a	n/a	n/a
<u>2006</u>						
Old Town Core	76.0%	\$180.52	\$137.15	403,690	306,712	\$55,366,322
East Alexandria	72.7%	\$159.81	\$116.24	788,035	573,214	\$91,603,953
Alexandria	69.5%	\$141.20	\$98.16	1,502,723	1,044,637	\$147,505,089
DC Metro	68.3%	\$141.54	\$96.71	n/a	n/a	n/a
<u>2007</u>						
Old Town Core	73.4%	\$191.20	\$140.25	379,398	278,311	\$53,211,708
East Alexandria	69.3%	\$168.06	\$116.54	783,202	543,125	\$91,277,526
Alexandria	68.8%	\$147.71	\$101.60	1,500,062	1,031,737	\$152,402,116
DC Metro	68.3%	\$149.33	\$102.44	n/a	n/a	n/a
<u>2008</u>						
Old Town Core	74.9%	\$197.99	\$148.23	408,800	306,048	\$60,594,544
East Alexandria	68.7%	\$176.29	\$121.10	920,621	632,396	\$111,487,464
Alexandria	68.1%	\$147.50	\$100.34	1,421,587	967,777	\$142,646,819
DC Metro	67.0%	\$153.26	\$102.73	n/a	n/a	n/a
<u>2009</u>						
Old Town Core	74.1%	\$187.67	\$138.99	444,538	329,227	\$61,784,435
East Alexandria	70.3%	\$163.22	\$114.68	1,011,383	710,593	\$115,980,448
Alexandria	67.5%	\$146.97	\$99.19	1,649,768	1,113,387	\$163,633,703
DC Metro	64.9%	\$144.93	\$94.04	n/a	n/a	n/a

Source: Smith Travel Research

- Market Strength in Old Town Core:

Within Alexandria, the Old Town core area represents the strongest lodging submarket. As shown in the preceding table, occupancies, ADR, and RevPAR in the Old Town core consistently and substantially exceed those in the overall Alexandria and broader regional markets.

The following table presents additional data on these properties' performances. Overall, with the exception of declines in 2009 from peak-year performances, over the last six years this market has shown strong growth in revenues, demand, and RevPAR, and for the entire period has maintained occupancy rates in excess of 73 percent.



TABLE 4

Market Indicators in Old Town Core Area Properties*						
<u>Year</u>	<u>Occupancy</u>	<u>ADR</u>	<u>RevPar</u>	<u>Supply</u>	<u>Demand</u>	<u>Revenue</u>
2004	79.4%	\$150.64	\$119.60	403,690	320,495	\$48,280,455
2005	81.3%	\$163.47	\$132.91	403,690	328,217	\$53,654,708
2006	76.0%	\$180.52	\$137.15	403,690	306,712	\$55,366,322
2007	73.4%	\$191.20	\$140.25	379,398	278,311	\$53,211,708
2008	74.9%	\$197.99	\$148.23	408,800	306,048	\$60,594,544
2009	74.1%	\$187.67	\$138.99	444,538	329,227	\$61,784,435
CAGR		4.5%	3.1%	1.9%	0.5%	5.1%
Aug YTD 2009	75.6%	\$187	\$142	294,844	222,848	\$41,749,778
Aug YTD 2010	79.5%	\$190	\$151	298,161	236,968	\$45,023,172
1-Yr. Growth		1.4%	6.6%	1.1%	6.3%	7.8%

* Includes Embassy Suites, Hampton Inn, Hilton Inn, Hotel Monaco, Lorien, Morrison House and Residence Inn (Duke St.)

Source: Smith Travel Research

- RevPAR Growth Overcomes Difficult Challenges:

It should be noted that the Old Town Core Area market has achieved its recent successes (shown in the preceding table) despite (1) declining regional employment (shown previously in Table 2) and (2) increasing competitive supply. New supply has included rooms at The Lorien (107 rms, 2008) as well as the Residence Inn Old Town (240 rms, 2008).

In addition to these core area properties, Table 5 below shows that new supply has also been added to nearby locations. This table presents market indices for an expanded trade area encompassing the Old Town core but also extending north to First Street, and south and southwest to Telegraph Road. Recent properties added to this area in recent years include the Westin hotel (319 rooms, 2007), and the Residence Inn Carlyle (181 rms, 2008). As this supply has increased, occupancies fell, but in 2010 have rebounded to a 77.1 percent year-to-date level. Moreover, despite the recent supply growth, this expanded “East Alexandria” submarket has continued to achieve RevPAR growth, as revenue growth has exceeded supply growth.



TABLE 5

Market Indicators in "East Alexandria"* Properties (First St. to Telegraph Rd.)

<u>Year</u>	<u>Occupancy</u>	<u>ADR</u>	<u>RevPar</u>	<u>Supply</u>	<u>Demand</u>	<u>Revenue</u>
2004	75.9%	\$135.19	\$102.58	788,035	597,991	\$80,840,242
2005	77.4%	\$146.29	\$113.26	788,035	610,112	\$89,254,766
2006	72.7%	\$159.81	\$116.24	788,035	573,214	\$91,603,953
2007	69.3%	\$168.06	\$116.54	783,202	543,125	\$91,277,526
2008	68.7%	\$176.29	\$121.10	920,621	632,396	\$111,487,464
2009	70.3%	\$163.22	\$114.68	1,011,383	710,593	\$115,980,448
CAGR	--	3.8%	2.3%	5.1%	3.5%	7.5%
Aug YTD 2009	72.0%	\$163.39	\$117.65	672,223	484,031	\$79,085,762
Aug YTD 2010	77.1%	\$163.39	\$125.97	675,540	520,826	\$85,097,415
1-Yr. Growth	--	0.0%	7.1%	0.5%	7.6%	7.6%

* Includes all properties included in the "Old Town Core Area" group shown in the preceding table as well as the Crowne Plaza, Holiday Inn & Suites, Sheraton Suites, Residence Inn Carlyle, Holiday Inn, Westin and Courtyard.

Source: Smith Travel Research

- Sustainable Advantages:

Old Town derives its advantages from (1) reasonable proximity to the King St. or Braddock Road Metro Stations; (2) the historic ambience of the Old Town district and the retail/restaurant presence along King Street; (3) its proximity to Reagan National Airport; and (4) the scarcity of other easily developable property in close-in suburban locations. Over a long-term time frame, new developments in the Potomac Yards area may be competitive for high-quality lodging, but over the next ten years Old Town will be able to offer the dominant location for future opportunities in Alexandria.

Within Old Town, the waterfront offers a prime location. Future improvements to the area (as envisioned in the City's waterfront plan) as well as expanded access options (e.g., water taxi service as well as trolleys and shuttles), will give the waterfront a prime location for future lodging development.

It should also be noted that several lodging brands (and entire companies, most notably Hyatt and Carlson, among others) -- maintain limited or no presence in Alexandria. Where such brands can identify desirable locations in strong markets such as Old Town, brand loyalty



introduces an additional market factor, wherein traveler brand preferences would drive additional business to Old Town.

If an historic property was well suited for adaptive reuse to a hotel the project may be able to capitalize on tax credits for rehabilitating historic property. The Historic Rehabilitation Tax Credit can effectively reduce the cost of rehabilitating an historic structure. Lower capital costs improve a project's financing feasibility.

III. SHORT-TERM PROSPECTS

In the short-term (2 to 3 years) future, the foregoing discussions portray a strong market, but hotel development in the waterfront core area faces challenges. These include:

- **Costs and Financing:** For institutional investors, lodging is the most volatile of the major sectors; rather than seeking tenants over 1-, 5- and 10-year lease terms, lodging properties must achieve occupancies on a nightly basis. Under current economic conditions, lenders remain cautious. Anecdotal evidence suggests that while investors are likely to pursue acquisitions of well-performing properties, new developments would incur high costs as and difficult financing terms.
- **Niche Limitations:** While Old Town appears to offer an upscale location with upscale properties, the upper-most tiers of the market area may be limited by (1) per diem GSA-imposed spending limits for room rates, which generally target regional middle-market averages; and (2) a leisure market that features a relatively high presence of families (compared to leisure segments at high-end properties in locations such as Georgetown or DC) – which often face more stringent budget constraints than couples.
- **Distance from Metro Station:** New hotels on the Old Town waterfront would sit more than one mile from the closest (King Street) Metro station. This relative disadvantage, however, can be partly offset by the waterfront's proximity to the Old Town core, by an improved waterfront setting with new amenities, and by a combination of transportation options that will include shuttle services, trolley service, and possibly expanded water taxi services.

Notwithstanding these challenges, it should be noted that, even without regional employment growth, Old Town Alexandria has supported additional lodging supply based on its sites' abilities to compete with other properties in Northern Virginia. Recent RevPAR gains during a time of (1) declining regional employment; and (2) new competitive supply provides a strong indicator that the market may have been underserved in Alexandria. Older properties, less upscale properties, and suboptimal locations may have contributed to this underservice. In any event, developers will perceive opportunities for upscale waterfront hotel development even in the absence of significant office or tourism growth. Regardless of the market's capacity or growth prospects, a high-quality hotel in an improved waterfront setting should be positioned to outperform other properties – in other parts of Northern Virginia as well as in Alexandria – and succeed.



IV. LONG-TERM DEVELOPMENT OUTLOOKS

Long-term development prospects for the core area waterfront will most likely overcome the short-term challenges. Such prospects will be driven by growth in general business conditions – as reflected in general office employment; by ongoing tourism growth; and by the strength of Old Town’s amenities. In forecasting additional hotel room capacity this analysis applies two alternative methodologies.

Methodology #1:

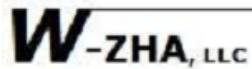
The first and simplest methodology is based on projected employment in Alexandria’s accommodations & food services industry sector. As forecasted by Moody’s economy.com, this is as follows:

<u>Accommodations/food service employment (000s)</u>	
2009	7.93
2020	11.08
2020 Growth Factor	39.8%
Annualized	3.1%

Applying this growth factor to 2009’s total room-demand of approximately 1.1 million room-nights (see Table 3) in Alexandria, this would increase by 443,000 rights, to roughly 1.55 million room-nights. Over a 365-day year, applying an overall City-wide market occupancy rate of 70 percent,² this growth would result in demand for approximately 1,700 additional rooms in Alexandria.

Forecast Methodology #1	
2009 Room-night demand	1,113,387
2020 Growth Factor	39.8%
2020 Room-Night Demand	1,556,011
Increased Room-Night Demand	442,624
New daily room demand (demand/365)	1,213
Supportable new rooms @ 70% occ.	1,732

² This assumption leads to a more conservative projection: If a lower occupancy rate is applied, then room-demand translates to a higher number of supportable rooms.



Old Town and the core area waterfront would occupy the strongest location and would capture the largest share of new development. As mentioned previously, Old Town has achieved the strongest performances in the Alexandria market, and new lodging development will face a limited range of other high-quality sites. Overall, under this forecast scenario, over 10 years Old Town should be able to capture roughly to 800 to 1,000 net new rooms, and the waterfront is likely to offer the prime location for such rooms.

Methodology #2:

The second forecast methodology presents a more conservative scenario, resting in the assumption that, over a ten-year time frame, visitation to national and international destinations such as the Washington area is likely to grow – simply as a function of increased population as well as increased national (and global) economic growth leading to increased incomes for travel. In deriving a reasonable growth factor, this methodology blending three different growth factors:

(1) Office employment growth in Alexandria. Interviews and statistics both indicate that Alexandria’s office tenant market is based predominantly in three sectors: “professional service,” “federal government” and nonprofit associations (“Religious, Grantmaking, Civic & Professional organizations”).

TABLE 6

ALEXANDRIA EMPLOYMENT TRENDS AND PROJECTIONS BY INDUSTRY SECTOR: 1990-2020									
	1990	2000	2005	2009	2010	2015	2020	CAGR 2005-2010	CAGR 2010-2020
Total Payroll Employment	81.42	99.17	106.56	113.16	113.73	129.78	138.07	1.3%	2.0%
Total Nonfarm	76.24	93.75	100.62	108.20	108.72	124.78	133.11	1.6%	2.0%
Natural Resources & Mining	0.14	0.26	0.23	0.20	0.20	0.20	0.19	-3.0%	-0.5%
Construction	3.29	2.89	4.20	3.10	2.93	3.98	4.05	-6.9%	3.3%
Manufacturing	1.88	1.99	1.87	1.70	1.62	1.83	1.89	-2.8%	1.5%
Wholesale Trade	2.78	2.64	2.86	2.09	2.05	2.37	2.47	-6.4%	1.9%
Retail Trade	11.07	9.01	8.77	7.78	8.08	9.02	9.16	-1.6%	1.3%
Transportation, Warehousing, & Utilities	2.70	2.79	2.26	2.13	2.11	2.19	2.09	-1.4%	-0.1%
Information	3.00	3.03	1.99	2.14	1.96	1.81	1.65	-0.3%	-1.7%
Financial Activities	7.87	6.86	6.83	6.33	6.23	6.81	7.05	-1.8%	1.2%
Professional & Business Services	12.21	21.60	24.78	26.05	25.98	31.72	35.45	1.0%	3.2%
Education & Health Services	6.53	7.78	8.46	8.08	8.33	9.64	10.70	-0.3%	2.5%
Leisure & Hospitality	7.30	8.31	9.08	8.75	8.85	10.80	12.04	-0.5%	3.1%
Arts, Entertainment, and Recreation	0.47	0.57	0.72	0.82	0.75	0.88	0.96	0.9%	2.4%
Accommodation and Food Services	6.83	7.74	8.36	7.93	8.09	9.92	11.08	-0.6%	3.2%
Other Services (except Public Administration)	6.03	9.92	11.81	14.00	14.83	16.67	17.28	4.7%	1.5%
Religious, Grantmaking, Civic, & Prof'l Org.	4.01	8.04	9.74	11.96	12.66	14.38	15.06	5.4%	1.8%
Government	11.44	16.67	17.48	25.84	25.56	27.80	29.15	7.9%	1.3%
Total Federal Government - Civilian	4.20	7.45	6.93	15.28	15.48	16.46	17.35	17.4%	1.1%
Total State Government	3.68	2.65	2.71	2.96	2.80	3.11	3.25	0.6%	1.5%
Total Local Government	3.55	6.57	7.83	7.61	7.29	8.23	8.56	-1.4%	1.6%
Non-BLS Sectors	5.18	5.42	5.94	4.97	5.01	5.00	4.97	-3.3%	-0.1%
Military Personnel	4.83	4.96	5.48	4.48	4.51	4.45	4.35	-3.8%	-0.4%

Source: moody's economy.com

Recent federal government civilian employment has helped drive lodging market in recent years. While this growth is likely to decelerate, forecasts indicate that growth will continue in Alexandria’s major office-oriented sectors at a rate of 2.2 percent per year over the 11-year (2009-2020) forecast period.



While this factor is substantially lower than the 2005-2009 growth factor, it provides a reasonable basis for projection.

TABLE 7

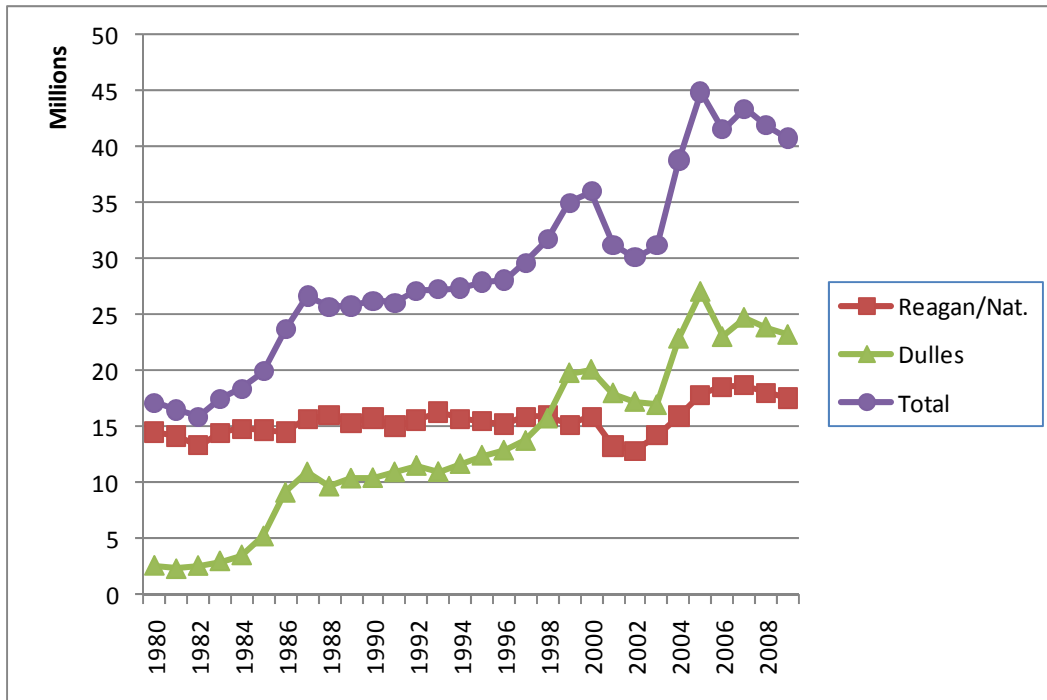
EMPLOYMENT IN MAJOR OFFICE SECTORS*: ALEXANDRIA, 2005-2020						
<u>2005</u>	<u>2009</u>	<u>2010</u>	<u>2015</u>	<u>2020</u>	CAGR <u>2005-09</u>	CAGR <u>2009-20</u>
41.45	53.29	54.12	62.57	67.87	6.5%	2.2%

* Includes professional & business services, religious, grantmaking, civic & professional organizations, and civilian federal government sectors.

Source: moody's economy.com

(2) Regional Deplanements: Airport activity provides as a reasonable proxy for regional overnight visitation. The following presents the historical trend of deplanements at Reagan/National and Dulles International Airports. While passenger volumes at Reagan/National have remained relatively stable, this is probably attributable to the airport's size and constrained ability to expand. In contrast, as its profile and capacity has expanded, since 1980 Dulles deplanements have increased from approximately 2 million deplaned passengers/year to more than 20 million passengers in 2009. Over this 30-year period, the total combined number of deplanements has approximately doubled, increasing from a range below 20 million annual passengers to more than 40 million.

FIGURE 1
Deplanements: Reagan/National and Dulles International Airports:
1980-2009



Over this long-term history, deplanements have increased at compounded annual averages of 4.6 percent in the 1980s, 3.1 percent in the 1990s, and 1.5 percent in the previous decade. Over the entire 29-year period, deplanements have increased at a compounded annual growth rate of 3.0 percent. For the purposes of projection, however, this analysis applies the lowest and most recent (1.5 percent) growth rate for regional visitation. This would result in 16.6 percent growth in visitation through 2020.

(3) GMP: On a macro- level, lodging bears a strong relationship to real GDP growth. As shown earlier in Table 2, Moody’s economy.com projects the Washington area’s GMP to grow at an annualized rate of 3.4 percent per year over the next four years. Extending this growth rate over a 10-year period, anticipated growth attributable to GDP growth would increase the regional lodging demand by 43.7 percent, enough to support an additional 635 rooms.

Applying each of these three growth factors to a one-third share of Alexandria’s 2009 room-night demand, the following table shows new room-night demand, which amounts to a blended total of 325,000 additional annual room-nights by 2020. Assuming a City-wide average market occupancy rate of 70 percent, this new room-night demand would support an additional 1,273 rooms.



TABLE 8

	Alexandria <u>Office Empl</u>	Regional <u>Deplanements</u>	DC <u>GMP</u>	Blended <u>Total</u>
2009 Room-Night Demand (1/3 shares)	371,129	371,129	371,129	1,113,387
Annualized Growth Rate	2.2%	1.5%	3.4%	2.4%
2020 Growth Factor	27.3%	16.6%	43.7%	29.2%
2020 Room-Night Demand	472,623	432,746	533,345	1,438,714
Increased Room-Night Demand	101,494	61,617	162,216	325,327
New avg. daily room demand	278	169	444	891
Supportable new rooms @ 70% occ.	397	241	635	1,273

Under this more conservative growth scenario, hotel development opportunities would be more limited than under the previous forecast. Given the more limited growth, however, developers would be less aggressive and would limit their projects to those on high-amenity sites. Thus, Old Town and the core area waterfront may be able to capture the largest share – roughly 700-900 rooms -- of this supportable room increase.

V. FORECAST CONCLUSION

Overall, considering the two different forecast methodologies, it is likely that over time, as economic cycles proceed, an improved core area waterfront could support new lodging development of roughly 700-1,000 new rooms. These new rooms would be offered in 3 to 5 properties that would most likely fit an upper-mid-price-with-food-service niche.