1907 East Wayzata Boulevard
Suite 250
Wayzata, Minnesota
55391

(952) 476-5900 telephone
(952) 476-0005 facsimile

MEMORANDUM

To: Ms. Lynn Peters

From: Bill Krueger

Date: July 17, 2009

Subject: Convention Center/Hotel Project Planning

Lynn,

The purpose of this memo is to provide a summary of the findings associated with our engagement with the Fox Cities Convention & Visitors Bureau and Fox Cities Chamber of Commerce (to be referred to as "Task Force") to evaluate preliminary hotel developer/operator interest in a potential public/private partnership opportunity for a convention center and hotel in the Fox Cities area.

Background and Work Completed

A Feasibility Study was completed and finalized in mid-2008 for a potential convention center in the Fox Cities. Study results suggested that unmet market demand existed for a larger convention center product than currently exists in the area and that a public/private partnership with an existing or potential new full-service hotel could represent the best opportunity for such a project. Conventions, Sports & Leisure International ("CSL") was engaged to assist the Task Force in furthering its evaluation of the viability and merits of a public/private partnership of this nature, with a focus on gauging preliminary private sector hotel developer/ownership interest. Specifically, the work involved the following:

- Selected from a proprietary database a targeted sample of more than 250 national and regional hotel developers and operators, including those that have entered into comparable public/private partnership transactions/agreements concerning hotel/convention center projects.
- Developed a Request for Expressions of Interest (RFEI) document that was designed to preliminarily gauge hotel developer/operator interest in the project. The RFEI provided a concise summary of the potential project and opportunity and requested brief letters of interest from prospective candidates.
- Received eight letter responses to the RFEI, including:
    1. Montclair Hotel & Resorts / Radisson Paper Valley
    2. Garfield Traub Development
    3. Rollie Winter Associates / Swift Hospitality
    4. Grubb & Ellis / Hoffman LLC / Pfefferle
    5. Mortenson Development
    6. Hostmark Hospitality Group
    7. Kinseth Hospitality Companies
    8. FM Hospitality

- Conducted, with participation of Ms. Lynn Peters and Mr. Bill Welch, telephone conference calls with interested partner candidates (as indicated through responses to the RFEI) to obtain information concerning envisioned development and operating models, branded prototypes, initial thoughts concerning capital contributions, site/location issues, deal structuring, key agreement terms and other such items.

Providing Context with Current Industry Conditions

Since the completion of the feasibility study, a "perfect storm" of detrimental nationwide economic issues struck the U.S. hospitality industry. National economic conditions significantly worsened and U.S. (and international) credit markets quickly were thrust into a crisis.

To frame the problem, according to a press release in November 2008 by PKF Hospitality Research (a firm that annually publishes a highly-regarded U.S. Hotel Industry Forecast):

> The speed and severity of the downtown in the national economy, both that which has already occurred, and that which is anticipated for the year ahead, has vastly exceeded our previous expectations. Thus, for only the second time since the events of 9/11, we feel that a mid-term update [to the 2009 Hotel Industry Forecast] is warranted. The projected deterioration in industry performance will be driven primarily by a 1.5 percent decline in 2009 lodging demand, aggravated by a 3.0 rise in supply. Given the increased competitive market conditions, U.S. hoteliers will only be able to raise their room rates by a mere 0.1 percent next year. The net result will be a 4.3 percent drop in RevPAR (revenue per available room). PKF now forecasts that the average U.S. hotel will suffer a 7.9 percent decline in profits in 2009.
>
> While the poor economic conditions present daunting challenges, they also create some beneficial side effects. The lack of financing has all but stopped the start of construction for new hotels for this year and next. Therefore, we will see fewer rooms open up in the later part of 2009 and into 2010. In addition, it should be noted that the vast majority of hotel owners are not overleveraged, and debt coverage ratios were high entering this industry recession. Foreclosures and bankruptcies will escalate, but we will not see an epidemic.

It is important to recognize the nuance placed in the last paragraph above. The "lack of financing" has effectively halted the "start" of construction for new hotels, but it is believed that various "pre-construction" *planning* will recommence more quickly than further-advanced construction projects. More specifically, as the credit market crisis continues to abate and more normalcy and certainty gradually return to the credit markets, it is believed that preliminary project planning consideration by developers and investors will likely recommence in earnest, which would pertain to the initial consideration of a potential public/private partnership arrangement for a project like that in the Fox Cities. "Consideration" is the key word here, which would relate to a response to an initial exploration of a hotel development opportunity.

In January 2009, David Lowe with Robert W. Baird & Co. summarized the core issues affecting the industry:

> The financial crisis has created a situation where money flows to safe havens. 13-week treasury bills have traded at one or two basis points. Banks won't lend to each other. This is really extreme. This is the equivalent of investors thinking that the world is going to end. The impact on hotel finance is: less debt available, tighter credit terms, commercial real estate asset overhang, refi issues, distressed sales, and higher cap rates. In the next few years, debt service coverage is more likely to be 135 percent instead of 120 percent , and LTVs (loan-to-values) will be at 50 percent to 60 percent.

These issues become especially problematic for a project in a mid-sized community like the Fox Cities. Small and mid-sized developers more often resort to traditional bank financing rather than non-traditional financing techniques and transactions leveraged with high equity. Over the past ten months, credit at traditional financial institutions has significantly tightened, with it only very recently exhibiting signs that it is loosening. For many years prior to this crisis, typical LTV (loan-to-value) requirements were between 75 and 80 percent (meaning loans were routinely given by banks for 75 to 80 percent of the hotel project's value and 20 to 25 percent of the remaining capital would have to be provided via developer equity, mezzanine financing or other funding—often obtained at a considerably higher interest rate). Now, with substantial tightening in lending standards, the cost of capital (via higher interest mezzanine financing and/or larger equity requirements) per new project has significantly affected the decision-making and risk-acceptance of many hotel developers, and in particular, smaller developers. It is believed that this change in financing terms is one of the most relevant issues constraining small to mid-sized market hotel development project consideration at the present time.

Given this abrupt industry change, many hotel developers (who often have equity stakes in operating hotels and also a number of projects in the development and construction pipeline) are believed to have quickly frozen new project consideration and are taking a "wait and see" approach until more certainty and clarity returns to the economy, credit markets, and hospitality industry. While the latest national economic data suggests that economy has recently "hit bottom", it is important to recognize that the performance/trend of both the hospitality and the overall visitor industry often lags general metrics of the overall economy by several months to a year.

Insight Drawn from Developer Conversations

The RFEI letters were mailed to a targeted list of more than 250 potential developer/operator candidates, including both national and regional firms that have been involved in hotel projects in the Fox Cities area and within Wisconsin. Based on CSL's experience with several other exercises of this nature in other communities, the response rate of expressions of interest (eight letters) was generally consistent or slightly lower than that experienced in the past for comparably-sized communities. Nevertheless, given the state of the economy, credit markets and hospitality industry, the response rate is understandable. Importantly, it is believed that most of the interested firms/teams represent very legitimate candidates for the Fox Cities project. Specifically, Montclair/Radisson Paper Valley and Pfefferle/Hoffman/Grubb & Ellis are teams with strong involvement in hotel assets and real estate in downtown Appleton that expressed interest. Additionally, Garfield Traub and Mortenson are both considered strong hotel developers that have extensive experience with the public/private partnership model in cities throughout the country. Kinseth Hospitality also has a strong track record of hospitality projects in Wisconsin and throughout the upper Midwest.

The following represents typical or noteworthy comments made by the five interested developer/operator candidates who were interviewed via conference call.

- All interviewed firms/teams emphasized the significant challenges of developing large projects in the current economic climate. The vast majority of projects that are currently being developed from a pure private sector standpoint are those representing smaller, limited-service hotel projects. Full-service hotel projects that are getting done are those in the largest metropolitan areas and those with public sector involvement.
- Most expressed concern over the community's ability to absorb an additional large full-service hotel property. It was believed that a new full-service hotel in a market the size of the Fox Cities (or Appleton) would likely require significant participation by the public sector to generate the needed return-on-investment for the private partner. Further, expecting the private hotel partner

to undertake the added "operating burden" (i.e., fund its ongoing operation) of convention space that is oversized for the property would likely further increase the amount of public sector project funding.

- Whereas, in past years, a typical new full-service hotel project of this nature was possible with equity contributions of 25 percent or less, the current environment now demands up to 50 percent equity. In the Fox Cities' case, it is believed that most of this would involve a public sector contribution (beyond the investment required in the convention center itself).
- Several of the interviewed firms/teams indicated that in today's development and financing environment, full-service hotels (of the type that would be required in the Fox Cities) are generally requiring approximately a 40 percent subsidy from the public sector (again, not including the cost of the larger convention center). Typical full-service hotel construction costs (including FF&E) are generally in the range of $200,000 to $250,000 per key. Assuming 300 guestrooms, order-of-magnitude construction costs for a new full-service hotel in the Fox Cities could approximate between $60 million and $75 million. Further assuming such a project would require a 40 percent subsidy by the public sector, suggests that between $24 million and $30 million in subsidy might be required by the public sector (not including the incremental costs for the larger convention center, which would also need to be borne by the public sector).
- Private sector loans for projects of this nature remain extremely difficult to access, even for the most financial stable developers in the industry. Nearly all the public/private projects of this type that are advancing in other communities either involve tax-exempt financing (i.e., the public sector issues bonds to finance the project at a lower interest rate than possible through private financing) or those that utilize recently-created tools such as Build America Bonds. In any case, the public sector is required to take the lead in financing and, in many cases, overall asset ownership.
- Developers indicated that return-on-investment issues are critical in their present decision-making with new projects. Many are currently focused on maximizing profitability of current hotel assets and dealing with "distressed" projects and those in or about to be in foreclosure. Any large full-service hotel project in a mid-sized market is perceived to have higher levels of risk, particularly if the private partner is asked to take the lead with funding. All of these issues become problematic when attempting to excite investors and secure loans in an extremely tight credit market.
- Those interviewed firms/teams that requested a copy of the Convention Center Feasibility Study agreed with the logic behind a scenario that involved a partnership with the Radisson.
- With regard to potential involvement in the project, the Montclair/Radisson Paper Valley group expressed significant interest; however, they explicitly indicated that the only convention center site that would be of interest to them would be Site 1B (site of the former St. Joseph Middle School, adjacent and directly south of the Radisson). While another downtown site was considered in the Feasibility Study (North Division & West Washington), its distance from the Radisson's existing conference space would make it extremely difficult to appropriately integrate physically and operationally and, as such, would not be viable from Montclair/Radisson's perspective.
- Additional analysis of hotel market conditions in the Fox Cities area would be required before the firms/teams could make more concrete decisions concerning their interest in any new project.

Suggestions for Next Steps

At this point, the following suggestions have been made for next steps in the Task Force's planning efforts.

1. Decide if, when and how attempts are made to involve the City of Appleton. From the public sector standpoint, the City of Appleton is the logical candidate for funding participation, under any of the primary scenarios. The Task Force may deem that the economic and political climate is not yet ripe for effectively turning over "stewardship" of the project to the City.
2. Attempt to better define the sources and magnitude of public sector funding that could be available for the project. At a minimum, it is believed that the public sector would need to fund the construction of the "convention center" portion of any project. For a project other than that involving the existing Radisson Paper Valley, nearly all signs point to the need for public sector involvement in funding the new hotel asset as well. In either case, it will be necessary to further "test the waters" with the City of Appleton and/or other public sector partners, and further refine funding options.
3. Maintain dialogue with Radisson Paper Valley. The evidence is strong that a partnership with the Radisson would represent the most logical opportunity with the highest benefits-to-costs for a Fox Cities convention center/hotel project. Nevertheless, it will be important for the public sector to retain "leverage" by keeping other options open. Attempts should be made to further define the parameters of such a partnership arrangement with the Radisson and how the physical product would be implemented and integrated (physically and operationally) in the current facility.
4. Take necessary steps to ensure the future availability of the preferred site adjacent to the Radisson (Site 1B). Under a potential partnership with the Radisson, it is believed that the site adjacent and directly south of the Radisson represents the only viable site. While there is another downtown site that was considered (North Division & West Washington), the Radisson has indicated that it would not be interested in partnering if this site is selected as the convention center location, as its distance from the Radisson's existing conference space would make it extremely difficult to appropriately integrate physically and operationally.
5. Consider conducting a Hotel Study. Such a study would evaluate the market for a new hotel and provide estimates of financial performance and asset value. This would be necessary to estimate the actual "feasibility gap" (i.e., the amount of money required of the public sector to make the return-on-investment attractive to private sector partners) of any new full-service hotel project.

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We’ve enjoyed working with the Task Force on this important project and would be happy to be of additional assistance upon request.