HVS

MARKET REPORT

Market Intelligence Report 2013 San Antonio

AUGUST 19, 2013

San Antonio's array of industries, including tourism, manufacturing, technology, and defense, provide strong demand to local hotels. Given the city's low unemployment and growing economy, hotel occupancies and average rates should continue to rise.

San Antonio's illustrious past and cosmopolitan present have come to symbolize the rich heritage of the state. Visitors by the millions are drawn to the city's meandering San Antonio River Walk, the eighteenth-century Spanish missions, and the Alamo. The coexistence of the old and the new is one reason San Antonio is viewed as an attractive place to relocate or visit. The San Antonio area is part of the greater south-central Texas economic base, which proved resilient following the recent recession. San Antonio features a variety of industries and employers that represent a cross-section of hotel demand potential. Some are national in scope, while others operate on a more local basis; many are engaged in high-tech research and manufacturing, with others are active in education, healthcare, defense, and government. Together, these engines of San Antonio's economy have proven strong demand generators for the city's hotels.

Economy Update

The following table illustrates historical and projected employment, population, and income data for the overall San Antonio market.

HISTORICAL & PROJECTED EMPLOYMENT, HOUSEHOLDS, POPULATION, AND HOUSEHOLD INCOME STATISTICS

Year	Total Employment	% Chg	Office Employment	% Chg	Industrial Employment	% Chg	Households	% Chg	Population	% Chg	Household Avg. Income	% Chg
2000	749,530	—	237,746	—	92,737	—	609,110	—	1,733,550	—	$76,746	—
2001	749,930	0.1 %	237,497	(0.1) %	89,048	(4.0) %	621,450	2.0 %	1,766,040	1.9 %	76,557	(0.2) %
2002	756,070	0.8	243,677	2.6	85,882	(3.6)	634,160	2.0	1,799,540	1.9	77,099	0.7
2003	753,970	(0.3)	243,301	(0.2)	83,401	(2.9)	647,860	2.2	1,836,500	2.1	80,323	4.2
2004	763,700	1.3	245,453	0.9	81,917	(1.8)	662,330	2.2	1,875,890	2.1	84,039	4.6
2005	793,770	3.9	257,702	5.0	83,750	2.2	683,600	3.2	1,938,360	3.3	88,720	5.6
2006	820,370	3.4	264,765	2.7	88,441	5.6	702,290	2.7	1,984,900	2.4	93,351	5.2
2007	843,900	2.9	271,533	2.6	89,408	1.1	721,940	2.8	2,037,200	2.6	97,495	4.4
2008	851,800	0.9	274,185	1.0	86,111	(3.7)	739,420	2.4	2,083,480	2.3	97,569	0.1
2009	835,070	(2.0)	272,748	(0.5)	82,509	(4.2)	756,390	2.3	2,129,600	2.2	95,503	(2.1)
2010	847,570	1.5	277,610	1.8	85,236	3.3	775,000	2.5	2,176,390	2.2	100,558	5.3
2011	852,130	0.5	276,099	(0.5)	86,644	1.7	791,820	2.2	2,218,190	1.9	103,595	3.0
2012	877,550	3.0	282,034	2.1	88,458	2.1	808,510	2.1	2,264,490	2.1	106,575	2.9
Forecasts												
2013	*901,870*	*2.8 %*	*289,326*	*2.6 %*	*89,140*	*0.8 %*	*825,750*	*2.1 %*	*2,309,860*	*2.0 %*	*$108,442*	*1.8 %*
2014	*934,710*	*3.6*	*300,517*	*3.9*	*90,608*	*1.6*	*844,570*	*2.3*	*2,356,640*	*2.0*	*112,672*	*3.9*
2015	*970,730*	*3.9*	*311,888*	*3.8*	*92,425*	*2.0*	*864,710*	*2.4*	*2,403,560*	*2.0*	*118,881*	*5.5*
2016	*1,003,090*	*3.3*	*322,315*	*3.3*	*93,706*	*1.4*	*884,620*	*2.3*	*2,449,990*	*1.9*	*124,811*	*5.0*
2017	*1,025,440*	*2.2*	*330,554*	*2.6*	*94,069*	*0.4*	*903,160*	*2.1*	*2,494,520*	*1.8*	*128,957*	*3.3*
Average Annual Compound Change												
2000 - 2012		1.3 %		1.4 %		(0.4) %		2.4 %		2.3 %		2.8 %
2000 - 2007		1.7		1.9		(0.5)		2.5		2.3		3.5
2007 - 2010		0.1		0.7		(1.6)		2.4		2.2		1.0
2010 - 2012		1.8		0.8		1.9		2.1		2.0		2.9
Forecast 2012 - 2017		*3.2 %*		*3.2 %*		*1.2 %*		*2.2 %*		*2.0 %*		*3.9 %*

Source: REIS Report, 4th Quarter, 2012

For the San Antonio market, of the roughly 900,000 persons employed, 32% work in offices and are categorized as office employees, while 10% are categorized as industrial employees. Total employment increased by an average annual compound rate of 0.1% during the recession of 2007 to 2010, followed by an improvement of 1.8% from 2010 to 2012. By comparison, office employment reflected compound change rates of 0.7% and 0.8% during the same respective periods. Total employment is expected to expand by 2.8% and office employment by 2.6% in 2013. Forecasts for 2012 through 2017 anticipate total employment will improve at an average annual compound rate of 3.2%, and office employment is forecast to improve by 3.2% on average annually during the same time frame. Household average income is expected to grow by 3.9% on average annually between 2012 through 2017.

The following table highlights major employers in the greater San Antonio-New Braunfels metropolitan area.

MAJOR EMPLOYERS

Rank	Firm	Number of Employees
1	Lackland Air Force Base	37,097
2	Fort Sam Houston - U.S. Army	32,000
3	USAA	15,000
4	H-E-B	14,588
5	Northside Independent School District	12,751
6	Randolph Air Force Base	11,068
7	North East Independent School District	10,522
8	City of San Antonio	9,145
9	Methodist Healthcare System	7,747
10	San Antonio Independent School District	7,000

Source: San Antonio Economic Development Foundation, 2012

Military installations constitute several of San Antonio's top employers. The recommendations in the most recent Base Realignment and Closure (BRAC) program call for the consolidation of a majority of the Defense Department medical training and research units in the U.S. to the San Antonio area. The relocation of these divisions and personnel will add several thousand military and civilian personnel to San Antonio and necessitate $2.2 billion in renovations and construction.

The following table summarizes unemployment data for Bexar County, the San Antonio-New Braunfels MSA, the state of Texas, and the U.S. from 2002 through 2011.

UNEMPLOYMENT STATISTICS

Year	County	MSA	State	U.S.
2002	5.8 %	5.7 %	6.4 %	5.8 %
2003	6.2	6.1	6.7	6.0
2004	5.8	5.6	6.0	5.5
2005	5.1	5.0	5.4	5.1
2006	4.7	4.6	4.9	4.6
2007	4.2	4.1	4.4	4.6
2008	4.8	4.7	4.9	5.8
2009	6.7	6.6	7.5	9.3
2010	7.5	7.4	8.2	9.6
2011	7.6	7.4	7.9	9.0
Recent Month - Jan				
2012	7.4 %	7.3 %	7.5 %	8.3 %
2013	6.6	6.6	6.9	7.9

* Letters shown next to data points (if any) reflect revised population controls and/or model re-estimation implemented by the BLS.

Source: U.S. Bureau of Labor Statistics

Unemployment in San Antonio began to rise slightly in 2008 as the region entered an economic slowdown; this trend continued in 2009 and 2010, concurrent with the worsening effects of the recession. After general stability in 2011, the most recent comparative period illustrates improvement, as shown in the latest data for 2013; moreover, the local unemployment rate remains below those of the state and nation. Reportedly, local employment has remained strong within the government and healthcare sectors, including strong employment levels at major employers such as the Department of Defense and Methodist Healthcare System.

Office Space Market Update

The following table details San Antonio's office space statistics, which are important indicators of the market's propensity to attract commercial demand.

OFFICE SPACE STATISTICS – MARKET OVERVIEW

Submarket	Inventory Buildings	Inventory Square Feet	Occupied Office Space	Vacancy Rate	Average Asking Lease Rate
1 CBD	57	4,985,000	3,594,200	27.9 %	$19.68
2 Northeast	98	5,612,000	4,871,200	13.2	21.70
3 West	116	9,296,000	7,492,600	19.4	19.45
4 Northwest	119	8,951,000	7,348,800	17.9	19.94
5 South	12	295,000	241,000	18.3	20.52
Totals and Averages	**402**	**29,139,000**	**23,547,800**	**19.2 %**	**$20.08**

Source: REIS Report, 4th Quarter, 2012

San Antonio's West submarket houses the largest inventory of office space, while the Northeast submarket enjoys the lowest vacancy rate. The Northeast submarket also has the highest average asking lease rate. The following table illustrates a trend of office space statistics for the overall San Antonio-New Braunfels metro market.

HISTORICAL AND PROJECTED OFFICE SPACE STATISTICS – GREATER MARKET

	San Antonio Market						
Year	Available Office Space	% Chg	Occupied Office Space	% Chg	Vacancy Rate	Asking Lease Rate	% Chg
2000	24,531,000	—	22,170,000	—	9.6 %	$16.78	—
2001	25,274,000	3.0 %	20,840,000	(6.0) %	17.5	17.06	1.7 %
2002	25,343,000	0.3	21,319,000	2.3	15.9	17.11	0.3
2003	25,372,000	0.1	20,539,000	(3.7)	19.0	16.96	(0.9)
2004	25,481,000	0.4	20,551,000	0.1	19.3	16.92	(0.2)
2005	25,784,000	1.2	21,063,000	2.5	18.3	17.25	2.0
2006	25,556,000	(0.9)	21,751,000	3.3	14.9	17.90	3.8
2007	26,214,000	2.6	22,545,000	3.7	14.0	18.89	5.5
2008	26,957,000	2.8	22,747,000	0.9	15.6	19.26	2.0
2009	27,791,000	3.1	22,650,000	(0.4)	18.5	19.50	1.2
2010	28,227,000	1.6	23,055,000	1.8	18.3	19.57	0.4
2011	28,631,000	1.4	23,570,000	2.2	17.7	19.91	1.7
2012	29,139,000	1.8	23,552,000	(0.1)	19.2	20.08	0.9
Forecasts							
2013	*29,413,000*	*0.9 %*	*23,982,000*	*1.8 %*	*18.5 %*	*$20.48*	*2.0 %*
2014	*29,629,000*	*0.7*	*24,382,000*	*1.7*	*17.7*	*21.03*	*2.7*
2015	*29,966,000*	*1.1*	*24,914,000*	*2.2*	*16.9*	*21.67*	*3.0*
2016	*30,390,000*	*1.4*	*25,562,000*	*2.6*	*15.9*	*22.36*	*3.2*
2017	*30,878,000*	*1.6*	*26,270,000*	*2.8*	*14.9*	*23.10*	*3.3*
Average Annual Compound Change							
2000 - 2012		1.4 %		0.5 %			1.5 %
2000 - 2007		1.0		0.2			1.7
2007 - 2010		2.5		0.7			1.2
2010 - 2012		1.6		1.1			1.3
Forecast 2012 - 2017		*1.2 %*		*2.2 %*			*2.8 %*

Source: REIS Report, 4th Quarter, 2012

The inventory of office space in the San Antonio market increased at an average annual compound rate of 1.4% from 2000 through 2012, while occupied office space expanded at an average annual rate of 0.5% over the same period. The onset of the recovery is evident in the 1.1% average annual change in occupied office space from 2010 to 2012. From 2012 through 2017, the inventory of occupied office space is forecast to increase at an average annual compound rate of 2.2%, with available office space expected to increase 1.2%; this would result in an anticipated vacancy rate of 15.9% in 2017, the lowest level since 2001.

Hotel Construction Update

The construction pipeline in San Antonio is relatively small given the massive influx of new supply the market received from 2005 to 2010. The most prominent project underway is the Hotel Pearl, located at the Pearl Brewery just north of Downtown; Kimpton Hotels & Restaurants will manage the hotel, which is expected to open in the fall of 2014. A number of smaller hotels are in the pipeline throughout the metro area; however, the percentage increase to the overall market supply will be minimal.

Outlook on Market Occupancy and Average Rate

Trends in the local lodging market indicate that demand growth has been significant over the past several years. As a result, occupancy levels in 2012 reflected a significant increase over those recorded in 2011. Average rate growth also accelerated in late 2012 and into early 2013. This trend reflects the market's movement in the hotel real estate cycle from recovery to expansion and growth.

Recent Hotel Transactions

The following table summarizes hotel transactions in the state of Texas since November of 2011.

REVIEW OF HOTEL TRANSACTIONS

Property	Location	Sale Date	Price	Rooms	Price/Rm
Courtyard by Marriott Houston Medical Center	Houston, Texas	Feb-13	$34,750,000	197	$176,396
Sheraton Gunter Hotel San Antonio	San Antonio, Texas	Nov-12	30,187,500	322	93,750
La Quinta Inn & Suites Willowbrook	Houston, Texas	Nov-12	2,900,000	76	38,158
Homewood Suites by Hilton Houston Woodlands	The Woodlands, Texas	Nov-12	12,000,000	91	131,868
Hyatt Place Dallas Arlington	Arlington, Texas	Oct-12	10,795,000	127	85,000
Hilton Garden Inn Fort Worth North	Fort Worth, Texas	Oct-12	7,200,000	98	73,469
Holiday Inn Express Austin North Central	Austin, Texas	Sep-12	7,400,000	101	73,267
Sheraton North Houston at George Bush Intercontinenta	Houston, Texas	Sep-12	35,000,000	420	83,333
Hilton Garden Inn Odessa	Odessa, Texas	Aug-12	11,750,000	100	117,500
Residence Inn by Marriott Dallas Arlington South	Arlington, Texas	Jul-12	15,500,000	96	161,458
Courtyard by Marriott Houston NASA Nassau Bay	Houston, Texas	Jul-12	14,632,000	124	118,000
Days Inn Denton	Denton, Texas	Jul-12	1,975,000	112	17,634
Hotel Derek	Houston, Texas	Jun-12	59,250,000	314	188,694
Motel 6 Wichita Falls	Wichita Falls, Texas	May-12	1,050,000	81	12,963
Aloft Houston Galleria	Houston, Texas	May-12	28,700,000	152	188,816
Night Hotel North Dallas	Dallas, Texas	May-12	6,500,000	350	18,571
Courtyard by Marriott Dallas Arlington South	Arlington, Texas	May-12	15,000,000	103	145,631
Holiday Inn San Antonio Airport	San Antonio, Texas	May-12	26,778,841	397	67,453
Motel 6 Dallas Arlington	Arlington, Texas	Apr-12	1,600,000	121	13,223
Best Western Inn & Suites New Braunfels	New Braunfels, Texas	Apr-12	3,115,000	61	51,066
Holiday Inn Express Frisco	Frisco, Texas	Apr-12	10,225,000	120	85,208
Renaissance Austin Arboretum	Austin, Texas	Mar-12	103,000,000	492	209,350
Days Inn Corpus Christi Airport	Corpus Christi, Texas	Mar-12	1,225,000	121	10,124
Crowne Plaza Dallas Galleria	Addison, Texas	Feb-12	20,000,000	429	46,620
Days Inn & Suites Tyler	Tyler, Texas	Feb-12	675,000	53	12,736
Comfort Inn Midland	Midland, Texas	Jan-12	5,300,000	68	77,941
Red Roof Inn Round Rock	Round Rock, Texas	Dec-11	2,900,000	107	27,103
Dallas Inn	Dallas, Texas	Dec-11	2,400,000	145	16,552
Sheraton Austin Hotel	Austin, Texas	Dec-11	95,200,000	365	260,822
Americas Best Value Inn & Suites Irving Dallas	Irving, Texas	Nov-11	1,900,000	125	15,200

San Antonio's hotel market has realized a steady pace of deals across a variety of market segments and acquisition

opportunities. The sales represent acquisitions of stabilized assets by institutional investors, as well as repositioning opportunities for entrepreneurial owner operators. An increased pace of lodging asset trades is anticipated in 2013, spurred by strengthened market conditions, improved hotel performance, and recent asset renovations.

Conclusion

Having moved through a phase of recovery, San Antonio's hotel industry is now poised for a period of steady growth. Increased demand has supported average rate growth for the San Antonio lodging market, and transactions and values continue to climb as local hoteliers regain pricing power. As access to capital and investment channels continues to broaden, investor interest in San Antonio-area upscale hotels is expected to remain strong, especially given recent performance trends and healthier metro-area economic fundamentals. Given the improvements in the national economy, the expansion of businesses in the city, and the promise of more tourism to area attractions, the outlook is optimistic for San Antonio hotel performance and development in the near term.