Critique/Update the Market and Economic Analysis for a Proposed Full-Service Downtown Hotel in Frederick, Maryland Conducted By Pinnacle Advisory Group and OPX

Presented to:

Prepared by:

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Final Report
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July 9, 2012

Mr. Gary McGuigan
Project Executive
Maryland Stadium Authority
333 W. Camden St., Suite 500
Baltimore, MD 21201

Dear Mr. McGuigan:

Crossroads Consulting Services LLC (Crossroads Consulting) and Hospitality and Gaming Solutions (HGS) are pleased to present this critique/update of the market and economic analysis issued to the City of Frederick (City) by Pinnacle Advisory Group and OPX (Pinnacle/OPX) in January of 2010 regarding a proposed downtown hotel and conference center in Frederick, Maryland. In accordance with our agreement, this report summarizes our research and analysis which is intended to assist the Maryland Stadium Authority (MSA) and the City with their decisions regarding the potential development of a new full-service hotel in downtown Frederick, Maryland.

The information contained in the report is based on estimates, assumptions, and information developed from market research; knowledge of the hotel industry; input from existing and potential demand generators; as well as other factors including data provided by the MSA, the City, and other secondary sources. We have utilized sources that are deemed to be reliable but cannot guarantee their accuracy. All information provided to us by others was not audited or verified and was assumed to be correct. Because the procedures were limited, we express no opinion or assurances of any kind on the achievability of any projected information contained herein and this report should not be relied upon for that purpose. Furthermore, there will be differences between projected and actual results because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances that occur after the date of this report. The accompanying report is restricted to internal use by the MSA and the City and may not be relied upon by any third party for any purpose including financing. Notwithstanding these limitations, it is understood that this document may be subject to public information laws and as such can be made available to the public upon request.

Although you have authorized reports to be sent electronically for your convenience, only the final hard copy report should be viewed as our work product.

We have enjoyed serving you on this engagement and look forward to providing you with continued service in the future.

Sincerely,

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Introduction

Crossroads Consulting and HGS were engaged by the MSA and the City to critique and update the *Market Analysis, Cash Flow Projections, and Strategic Recommendations for a Proposed Downtown Hotel and Conference Center* report which was prepared by Pinnacle/OPX and issued in January of 2010. The Pinnacle/OPX assessment found that there was demand for a 200-room full-service, nationally branded hotel with meeting and banquet space in downtown Frederick. The Pinnacle/OPX study did not recommend a conference center as defined by the International Association of Conference Centers (IACC) which includes certain criteria related to priority of business, design, business services, food/beverage, and technology requirements.

Scope of Research and Analysis

The primary scope of work completed during our assessment included the following:

- Meeting with representatives of the MSA, City and County Economic Development, Tourism Council of Frederick County, and the Chamber of Commerce in Frederick to gather relevant data and input for the proposed new full-service hotel.
- Updating relevant metrics in the market area which included population trends, accessibility, employment base, tourism statistics, as well as the status of major developments in Frederick.
- Touring and providing input on each of the potential site options in downtown Frederick with respect to its location, access, ancillary amenities and overall suitability for hotel operations.
- Identifying the supply of existing hotels in the market deemed competitive to the proposed new full-service hotel.
- Touring and interviewing competitive hotels in the market area which included a site inspection at each property.
- Gathering information regarding performance metrics of the competitive hotels via interviews with on-site management and/or from other sources such as representatives of the various brands within the Frederick hotel market.
- Re-evaluating the hotel supply and demand in the lodging market and analyzing available data from Smith Travel Research.
- Conducting interviews with select existing and potential lodging demand generators in the Frederick market including, but not limited to:
  - Bechtel Corporation
  - Fort Detrick
  - Frederick County Government
  - Frederick Memorial Health Care
  - Lonza Walkersville
  - MedImmune
  - Mount Mary's University
  - SAIC-Frederick
  - State Farm
  - United Health Care
  - Wells Fargo Home Mortgage

- Contacting various national hotel brands to gauge their relative interest and ability to develop a full-service hotel in downtown Frederick.
- Commenting on hotel construction design trends.
- Preparing a five-year estimate of occupancy levels, average daily room rates, and financial results for the proposed hotel commencing January 1, 2016.
- Preparing an estimate of economic and fiscal impacts associated with on-going operations of the proposed new hotel.
- Summarizing our findings, conclusions and recommendations into a written report.

Executive Summary

This section summarizes key points related to our critique and update of the *Market Analysis, Cash Flow Projections, and Strategic Recommendations for a Proposed Downtown Hotel and Conference Center* report that was prepared by Pinnacle/OPX and issued in January of 2010. The Pinnacle/OPX assessment found that there was demand for a 200-room full-service, nationally branded hotel with meeting and banquet space in downtown Frederick. The Pinnacle/OPX study did not recommend a conference center as defined by the IACC which includes certain criteria related to priority of business, design, business services, food/beverage, and technology requirements. IACC's exacting standards and stringent guidelines are meant to ensure the highest quality conference facilities and services among its certified members. Conference centers differentiate themselves from hotels in a number of ways including their focus on small to medium sized meetings without the distraction of leisure and/or individual business travelers.

In addition, the proposed downtown hotel is anticipated to be privately owned and operated which differentiates it from a traditional convention center which are typically publicly owned and publicly funded both in terms of capital construction and on-going operating subsidies.

Market Considerations

Frederick has a diverse economic base which is complemented by an educated workforce, a vibrant business community and a thriving arts community. Frederick County is the largest county in terms of acreage in Maryland and the City of Frederick is the second largest municipality in Maryland. It is strategically located within close proximity to two major metropolitan areas (Baltimore and Washington D.C.) and it serves as the northern anchor of the Interstate 270 technology corridor. Despite economic challenges during the past few years, Frederick remains strong and continues to grow in high-tech economic sectors.

Frederick appears to be a sustainable community for future hotel development. Area economics and market forces positively impacting the City’s sustainability include the following:

- Frederick’s population underwent substantial growth from 1990 to 2010 and the short-term forecast for population growth is stable. In addition, Frederick is well-situated near several major population centers.
- Fort Detrick is a 1,200-acre Army base that has a complex of biological laboratories, medical and agricultural research and communications facilities. In addition, five cabinet-level agencies are housed on Fort Detrick alongside the Frederick National Laboratory for Cancer Research, which occupies approximately 68 acres of the overall base site.
- The City and County have a diverse employment base with industries that include bioscience, insurance, finance, government, information technology, healthcare and manufacturing. According to Examination Management Services, Inc. (EMSI), in 2010 the Frederick area gained jobs in the following sectors:

- Arts, entertainment and recreation (9%)
- Professional, scientific, and technical field (4%)
- Accommodations and food service (3%)
- Healthcare (2%)

- In 2011, Frederick County posted the highest percentage increase in hotel room demand within the State of Maryland which translated into estimated tourism expenditures of over $300 million.
- In 2009, the City annexed an additional 795 acres setting the stage for continued employment growth over the next 20 years. Those annexations are in various stages of design and development approvals. It is estimated that the annexations will generate 3.7 million square feet of non-residential square footage for employment and retail uses that will deliver 12,500 new jobs. Additionally, an estimated 2,000 new residential dwelling units are planned that could house approximately 4,900 new residents.

Competitive Set – Market Demand Characteristics

The defined competitive set for the Frederick hotel market consists of eight properties that total 948 rooms. The following table illustrates the historical hotel demand for the competitive set.

Historical Demand - Frederick Hotel Market				
Year	Room Supply	Room Demand	Occupancy	Average Daily Room Rate
2007	328,860	208,861	63.5%	$106.30
2008	346,020	231,773	67.0%	$105.22
2009	346,020	243,827	70.5%	$103.66
2010	346,020	229,289	66.3%	$106.12
2011	346,020	254,467	73.5%	$106.68

Sources: Smith Travel Research; HGS.

With regard to new supply, there is currently one property under construction, a 120-room Town Place Suites hotel by Marriott, which is scheduled to be completed in the summer of 2012. The distribution of room night demand captured by the competitive set of hotels in 2011 consisted of commercial individual travelers (35%), government (28%), group (20%) and leisure (17%). All of the market segments are expected to experience modest growth in the coming years.

Program, Design and Construction Cost Trends

Guest expectations for hotels are evolving to reflect the way people live and the way they aspire to live. As such, hotel development is gravitating toward hospitality brands that emphasize design, convenience, and flexibility.

These 21st century travelers are changing the way brands and developers approach hotel projects, with fresh thinking reflected in new multi-purpose lobbies which include introducing more food and beverage opportunities and transforming the lobby into a revenue generator. Hotel guest rooms are getting wider, squarer, and more functional.

Hotel design has undergone dramatic changes in the past decade. The square footage of the guest rooms is a crucial component in programming a hotel. Some of the major brands changed their minimum square footage requirements which precluded some hotels from staying with the brand and limited their branding options in the future.

Proposed Program Characteristics

Based on the updated market research, it is recommended that the proposed hotel offer 200 guest rooms in a full-service, branded property in downtown Frederick. Given recent design trends, it is also recommended that guest rooms be a minimum of 325 to 350 square feet to ensure long-term flexibility among the major hotel brands. The proposed hotel should seek to include the following services and amenities which are consistent with the Pinnacle/OPX report:

- Fitness Center
- Business Center
- Wi-Fi connectivity
- Swimming Pool
- Ancillary Retail Outlets
- Food and Beverage
  - — Casual Restaurant and Lounge
  - — Pantry
  - — Room Service

- Meeting Space - It is recommended that the proposed hotel offer approximately 14,000 to 15,000 square feet of meeting space which includes a 5,000 to 6,000 square foot ballroom, pre-function space as well as individual break-out and boardroom configured space. This space should be configured with a flexible layout to accommodate a variety of user groups. The limited amount of meeting/ballroom space currently offered in the area causes some events requiring meeting/banquet space to host their events elsewhere due to availability and/or configuration of space. Further, stakeholders and potential users indicated that there is demand in Frederick for higher end meeting and banquet space than currently offered in the market both in terms of product offering and pricing. As such, the proposed property is not envisioned to compete on a regular basis with existing meeting/ banquet facilities in the community.

The client group has identified several potential sites in downtown Frederick. Assuming that the majority of hotel-related business will be drive-in, primary considerations when selecting the site should include ingress/egress to and from the property, availability of on-site and nearby parking as well as proximity to downtown amenities such as restaurants and shopping. For purposes of this analysis, it is assumed that the chosen site will be adequate in terms of these factors.

Proposed Hotel – Comparison of Demand Characteristics

A comparison of key operating characteristics of the proposed new full-service hotel is provided in the following table. Pinnacle/ OPX assumed stabilization in year 3 whereas HGS assumes this occurs in year 4. Although both studies assume 72% occupancy, HGS estimates a 21% lower overall ADR which is partially attributable to the change in projected market mix. Based on the updated market research, HGS estimates less leisure, group and commercial individual demand and more government related demand as compared to the Pinnacle/OPX report.

Comparison of Demand Characteristics - Stabilized Year				
Category	**Pinnacle/OPX**	**HGS**	**Amount Difference**	**Percent Difference**
Total Rooms	200	200		
Stabilized Year	Year 3 - 2016	Year 4 - 2019		
Market Mix				
Leisure	10,016	7,884	(2,132)	-21%
Group	17,179	16,294	(885)	-5%
Government	3,259	8,935	5,676	174%
Commercial Individual	22,122	19,447	(2,675)	-12%
Total Room Nights	**52,576**	**52,560**	**(16)**	**0%**
Occupancy	72%	72%	0%	0%
Average Daily Rate (ADR) - 2011 $	$178	$140	($38)	-21%

Sources: Pinnacle/OPX; HGS.

The proposed hotel will be the first full-service and the first branded property in downtown Frederick. Development of the proposed hotel should accommodate existing unaccommodated demand and induce incremental new demand in the market. It is assumed that the proposed full-service hotel will be privately owned and operated. Our research indicated that several major hotel companies have an interest in potentially developing the proposed 200-room full-service hotel in downtown Frederick.

Proposed Hotel – Comparison of Financial Operations

Although there are differences among individual line items, net operating income at the proposed new hotel is projected to be comparable to that in the Pinnacle/OPX study.

Comparison of Estimated Financial Operations - Stabilized Year ($000s)				
Category	Pinnacle/OPX Year 3 - 2016	HGS Year 4 - 2019	Amount Difference	Percent Difference
Operating Revenues				
Room	$9,348	$7,361	($1,987)	-21%
Food/Beverage	5,917	2,875	(3,042)	-51%
Telephone		34	34	
Other	905	460	(445)	-49%
Total	16,170	10,731	(5,440)	-34%
Operating Expenses				
Room	2,011	1,403	(608)	-30%
Food/Beverage	4,260	2,013	(2,247)	-53%
Telephone	653	36	(617)	-94%
Administrative and General	1,453	707	(746)	-51%
Marketing	1,639	788	(851)	-52%
Property Operations and Maintenance	568	578	9	2%
Energy	677	560	(117)	-17%
Management Fee	485	322	(163)	-34%
Total	11,747	6,408	(5,339)	-45%
Non-Operating Expenses				
Property Taxes	590	694	104	18%
Insurance	142	83	(59)	-42%
Reserve for Replacement	647	429	(218)	-34%
Total	1,379	1,206	(173)	-13%
Net Operating Income	**$3,044**	**$3,116**	**$72**	**2%**

Notes: All amounts are shown in 2011 dollars.
Other revenues in the Pinnacle/OPX study include telephone charges.

Sources: Pinnacle/OPX; HGS.

Economic and Fiscal Impacts

The proposed increase in hotel rooms in downtown Frederick should benefit the City, County and the State in terms of both economic and fiscal benefits. While there may be some shift of existing room nights in the area to the proposed new hotel, it is not likely to be significant given that the proposed hotel will be the only full-service hotel relative to the existing room supply.

In a stabilized year, the proposed hotel is estimated to generate approximately 52,600 room nights which would create approximately $16.5 million in direct spending in 2011 dollars. Outputs from the IMPLAN model indicate that total output, including direct, indirect and induced effects, generated from the proposed hotel's operations could be approximately $25.9 million in 2011 dollars. This spending is estimated to support approximately 280 jobs that would create $9.0 million in personal earnings. These transactions are subject to taxes that are estimated to generate $1.9 million in 2011 dollars at the local and State levels.

Overall Summary

While some of the market and economic characteristics have changed since the Pinnacle/OPX report, market demand still exists for the proposed new full-service hotel in downtown Frederick. Given updated market research, the distribution of room demand by market segment differs from the previous report which directly impacts the estimate of average room rates and resulting financial operating characteristics. However, the revised estimate of net operating income is comparable to that in the Pinnacle/OPX study. Due to methodology differences, economic impact estimates are not directly comparable between the two studies.

Next Steps

A market/economic analysis is an initial step in any planning process. Based on market research and corresponding economic/fiscal benefits that could potentially be generated by the proposed new hotel, next steps may include:

- Conduct a more detailed site comparison and select a definitive site for the proposed new hotel.
- Select a hotel developer, operator, designer, builder, and property brand.
- Refine proposed program into a more detailed spatial program and conceptual design which maximizes marketability relative to competitive set, operational functionality, physical site constraints, and minimizes cost.
- Develop construction and total project costs.
- Develop a cost-benefit analysis including the estimated return on investment for potential funding partners.
- Identify a potential financing strategy for the project which may ultimately require some level of public participation.

Because the information presented in the executive summary is extracted from the more detailed analysis, it is important for the reader to review the report in its entirety in order to gain a better understanding of the research, methodology and assumptions used. The remainder of this report summarizes the key findings and conclusions from our research and analysis which can serve as a tool for the City's and the MSA's on-going planning decisions related to the proposed new full-service hotel.

General Market Overview

The comprehensive Area Analysis section in the previous report prepared by Pinnacle/OPX identified and analyzed trends in population, average household income, employment, unemployment rates, transportation, Fort Detrick, Frederick National Laboratory for Cancer Research, office, tourism and major developments in Frederick. Our critique relative to this section focuses on significant changes in the area since the Pinnacle/OPX report was issued in January of 2010.

Population

As illustrated in the following table, the City's population has sustained higher average annual growth over the last 12 years compared to the County and State. Population in each of the three profiled jurisdictions is projected to remain relatively stable in the short-term.

Trends in Population

Data	City of Frederick	Frederick County	State of Maryland
2000 Census	52,767	195,277	5,296,486
2012 Estimate	65,857	238,444	5,836,711
2017 Projection	68,880	252,435	6,014,316
Average Annual Growth			
2000-2012	2.5%	2.2%	1.0%
2012-2017	0.9%	1.2%	0.6%

Source: Claritas

Frederick is well-situated near several population centers. The following table illustrates major population and commercial centers within 500 miles of Frederick.

Major Population Centers

City	Distance to Frederick, MD (in miles)
Washington D.C.	44
Baltimore, MD	52
Richmond, VA	145
Philadelphia, PA	153
Pittsburgh, PA	198
New York, NY	240
Cleveland, OH	328
Charlotte, NC	436
Boston, MA	464
Detroit, MI	485

Source: Frederick County Office of Economic Development.

Accessibility

Accessibility via air and highway are important factors to both individual and group travelers. In addition, the location and accessibility of a hotel relative to the business core, restaurants, and entertainment establishments can impact its marketability for certain types of business such as individual commercial travelers, social functions, and group meetings.

Frederick is accessible east and west via Interstate 70 which flows into Baltimore and south via Interstate 270 into Washington, D.C. As shown in the adjacent map, the City is also accessible to the broader interstate system into other Mid-Atlantic and Northeast destinations.

Air access is considered to be an important factor in terms of accommodating many commercial and government travelers, particularly for some group business. Frederick is serviced by the Frederick Municipal Airport, the second largest general aviation airport in Maryland, which recently completed an air traffic control tower and is planning a runway extension from 5,300 feet to 6,000 feet to accommodate corporate jet aircraft.

The City is also proximate to the Baltimore-Washington International Airport, which is located approximately 50 miles east, Ronald Reagan National Airport and Dulles International Airport, which are situated approximately 50 miles from Frederick. The Federal Aviation Administration (FAA) defines enplanements as domestic, territorial and international passengers who board an aircraft in scheduled and non-scheduled service of aircraft.

As shown in the following table, the number of passenger enplanements at Baltimore-Washington International Airport, Reagan National Airport and Dulles International Airport have increased 7.4%, 39.4%, and 32.9%, respectively, during the profiled period despite economic conditions that have negatively impacted travel trends in other destinations.

Baltimore-Washington International Thurgood Marshall Airport			Ronald Reagan Washington National Airport			Dulles International Airport		
Year	Passenger Enplanements	Percentage Change	Year	Passenger Enplanements	Percentage Change	Year	Passenger Enplanements	Percentage Change
2001	10,098,700		2001	6,267,400		2001	8,484,100	
2002	9,367,500	-7.2%	2002	6,172,100	-1.5%	2002	7,848,900	-7.5%
2003	9,768,000	4.3%	2003	6,813,100	10.4%	2003	8,050,500	2.6%
2004	10,103,600	3.4%	2004	7,661,500	12.5%	2004	10,961,600	36.2%
2005	9,829,400	-2.7%	2005	8,623,900	12.6%	2005	13,032,500	18.9%
2006	10,297,600	4.8%	2006	8,973,400	4.1%	2006	11,045,200	-15.2%
2007	10,487,800	1.8%	2007	9,038,200	0.7%	2007	11,789,400	6.7%
2008	10,215,200	-2.6%	2008	8,704,500	-3.7%	2008	11,348,800	-3.7%
2009	10,339,000	1.2%	2009	8,490,300	-2.5%	2009	11,132,100	-1.9%
2010	10,848,600	4.9%	2010	8,736,800	2.9%	2010	11,276,500	1.3%
Average	**10,135,500**		**Average**	**7,948,100**		**Average**	**10,497,000**	
10-Year Change	**7.4%**		**10-Year Change**	**39.4%**		**10-Year Change**	**32.9%**	

Note: Passenger enplanements are rounded to the hundred.

Source: Federal Aviation Administration.

Major Employers

The City and County have a diverse employment base with industries that include bioscience, insurance, finance, government, information technology, healthcare and manufacturing. According to Examination Management Services, Inc. (EMSI), the Frederick area gained jobs in the following sectors in 2010:

- Arts, entertainment and recreation (9%)
- Professional, scientific, and technical field (4%)
- Accommodations and food service (3%)
- Healthcare (2%)

The adjacent table shows the top ten Frederick County employers in terms of the number of employees.

Despite the recent recession, Frederick's overall employment base has been fairly stable in recent years. In addition, some top employers like Fort Detrick, Wells Fargo Home Mortgage, and Frederick Memorial Healthcare experienced an increase in recent years.

Major Employers - Frederick County		
Employer	**Industry**	**Employees**
Fort Detrick	Army, Medical Research	9,200
Frederick County Board of Education	Education	5,540
Frederick Memorial Healthcare	Health Care	2,295
Frederick County Government	Government	2,130
SAIC-Frederick	Medical Research	1,965
Bechtel Power	Engineering, Construction and Telecommunications	1,578
Wells Fargo Home Mortgage	Mortgage Loans and Service	1,500
Frederick Community College	Education	899
Frederick City Government	Government	852
United Health Care	Insurance	832
Total		**26,791**

Source: Frederick County Division of Business Development.

Fort Detrick is a 1,200 acre Army base that has a complex of biological laboratories, medical and agricultural research and communications facilities. In addition, five cabinet-level agencies are housed on Fort Detrick known as the National Interagency Biodefense Campus (NIBC). The NIBC is the home of some of the most important scientific studies on disease such as malaria and cancer as well as studies on characterizing and protecting citizens from biological threats. In addition, Fort Detrick is home to the Frederick National Laboratory for Cancer Research, which occupies approximately 68 acres of the overall base site. Fort Detrick has more than 38 mission partners developing cutting edge technology and pursuit of health protection and medical advances. In 2009, almost $3 billion in contracts were awarded by Fort Detrick. Of the $3 billion, more than $600 million was awarded to Maryland-based companies, including $55 million which was won by regional companies in the greater Frederick area. Given it is the area's largest employer and has on-going contracts with other area and State businesses, Fort Detrick is a significant demand generator for local lodging and meeting space.

Commercial Office Market

The state of an area's commercial office market can impact the lodging market in terms of both overnight stays as well as meeting/event space rentals. The following table outlines Frederick County's office market statistics provided by CB Richard Ellis (CBRE). As shown, the occupied space has declined since the Pinnacle/OPX report which is primarily due to CitiMortgage and Bechtel vacating approximately 340,000 square feet.

Frederick County Office Market Statistics

Year	Total Office Space	% Change	Occupied Space	% Change	Vacancy Rate	Average Lease Rate	% Change
2009	4,498,738		4,291,481			$20.66	
2011	4,601,514	2.3%	3,561,572	-17.0%	22.6%	$23.70	14.7%

Source: CBRE.

Tourism Statistics

According to Tourism Economics, tourism expenditures in 2010 were $284.1 million in Frederick County, an increase of approximately 1% over the prior year. Although, the 2011 data has not been finalized, initial estimates indicate that Frederick County experienced a 13.8% increase in room demand in 2011 which was the largest increase of any County in the State of Maryland. This translates into estimated tourism expenditures of over $300 million in 2011.

Sustainability and Major Developments in Frederick

When assessing the market for new hotel development it is important to gain an understanding of the future developments underway or in the planning stages in addition to the market's current status. The following summarizes other planned or on-going developments throughout Frederick County.

- Frederick is home to more than 70 life science companies such as Life Technologies, Lonza Bioscience, Southern Research Institute, MedImmune and Eminent Services. Tremendous growth has occurred in this sector in the past five years and it is expected that this sector will grow and thrive in the future.

- The Frederick National Laboratory for Cancer Research will open its 330,000 square foot facility in the spring of 2012. The range of operations includes proteomics, genomics and other translation research disciplines, including bio-pharmacological manufacturing capability. The 62- acre campus has room to expand by another 570,000 square feet targeted for future life science and advanced technology partners.

- MedImmune recently completed a new $250 million, 397,000 square foot plant adjacent to its existing facility. The new plant will bring 100 new jobs and enhance MedImmune's internal manufacturing capabilities for monoclonal antibodies.

- Life Technologies expanded the facility's manufacturing land research and development capabilities by 56,000 square feet in 2010. This international company posted sales of $3.3 billion in 2010 and its Frederick facilities grew by 100 employees last year. It is expected to generate additional jobs in the future.

- Lonza Bioscience is located in Walkerville, is headquartered in Switzerland and is one of the world's largest suppliers of pharmaceuticals, life sciences and health care products and services. Locally, the company has 450 employees and recently completed a $26 million expansion that houses cell production facilities, complete with clean-rooms on their 115 acre campus.

- According to Dun and Bradstreet, there are 635 arts-related businesses in Frederick County, employing over 1,800 people. In 2009, there were 513 creative sector businesses, a number that increased by more than 100 in the past two years.

- In 2009, the City annexed 795 acres setting the stage for continued employment growth over the next 20 years. Those annexations are in various stages of design and development approvals. It is estimated that the annexations will generate 3.7 million square feet of non-residential square footage for employment and retail uses and deliver 12,500 new jobs. Additionally, some 2,000 new residential dwelling units will be constructed to house approximately 4,900 new residents. The City is currently reviewing two separate annexation requests. The first annexation will enlarge a 2009 approved annexation by adding 256 acres to the northern area of Frederick while maintaining the previously approved residential dwelling units. The second annexation will bring 302 acres of land into the City with 750 residential dwelling units and approximately 1,800 new residents.

In summary, market characteristics suggest that Frederick is a sustainable community for future hotel development.

Program, Design and Construction Cost Trends

Hotel design has undergone dramatic changes in the past decade. The goal is to design an experience that flows from check-in to sleeping to bathing to dining. Psychographic profiles are driving design decisions. It is no longer enough for a hotel to label itself as business or leisure. People are conducting business while they play and they are playing while they travel for business. There has to be a degree of escapism even in business hotels - people want to go beyond their routine and try something new.

People are taking better care of themselves. For example, they more commonly frequent spas. As a result, guest bathrooms have become more spa-like. They offer more natural light. In space-conscious, high-end city hotels, large pampering shower experiences are present rather than a tub and shower. The exception is a soaking tub where space allows. The one place in which bathtubs are still a must is in family-oriented resorts and then, usually, only in double-bedded rooms.

When guests work on their laptops, they do not want to look at a wall. They want to see a view, but they also want to watch CNN. They want enough space to do yoga or Pilates in their rooms. In March of 2012, InterContinental Hotels Group (IHG) announced the launch of their health and fitness orientated hotel brand—EVEN Hotels. Guestrooms are getting bigger because they have to be multi-functional. Operators used to think that small rooms encouraged guests to go out and spend more in the restaurants and bars. Now, hoteliers are definitely realizing that guests are willing to pay more for the lifestyle experience.

Guestrooms used to give guests a dining table and desks. Now, a table on casters can be rolled up to the foot of the bed. Guests can decide how that table is used—whether as a desk or a table for breakfast in bed. Designers have to think about how guests use the room. They need a place to relax and watch TV, a place to just lounge. They need to be able to customize the experience by changing lighting levels.

New forms of wellness are being incorporated. Guestrooms are being designed so that the bathrooms are becoming one with the room so that visual space is borrowed between the bedroom and the bathroom. Tubs are often being replaced by rain showers and toilets are being concealed in innovative ways.

The square footage of guest rooms is a crucial component in programming a hotel. Some of the major brands changed their minimum square footage requirements which resulted in precluding some hotels from staying with the brand and limited their branding options in the future. Starwood, Marriott and Inter-Continental Hotels Group have lost several properties due to the corporate design changes and corporate brand minimal square footage requirements.

Design Trends

Guest expectations for hotels are evolving to reflect the way they live now—and, even better, the way they aspire to live—and are gravitating toward hospitality brands that emphasize design, convenience, and flexibility.

These 21st century travelers are changing the way the brands and developers approach hotel projects, with fresh thinking reflected in new multipurpose lobbies, to wider—but sometimes smaller—guest rooms, to guest bathrooms with no bathtub. Attitudes are changing with regard to energy management, self-serve check-in kiosks, and select-service brands, and all these changes are being reflected in new design concepts.

From interviews with hoteliers and hotel design experts, *Building Design & Construction* uncovered several trends that are having the greatest influence on the next generation of hotels.

Lobbies are going multipurpose **-** Comfortable, casual, and usable lobbies—marketed as great rooms or gathering rooms—are replacing formal, underutilized lobbies. There is no longer a separate bar, separate sitting area, separate check-in space, separate anything. Instead, hotels are turning the large lobby into a series of small, open living rooms to draw guests out of their rooms and encourage them to congregate.

The small living room zones are defined by higher ceilings, fireplaces, more columns and furniture arrangements that offer zones for either social interaction or solitude. The cocktail bar and lounge are extensions of the whole space. There are informal meeting spaces with work tables, and wireless internet availability is becoming common. These informal meeting spaces are of particular importance because it is socially more comfortable for business travelers to meet in the lobby than in a guest room.

People are more inclined to spend time in the lobby when food and beverages are available, introducing more food and beverage opportunities, including grab-and-go retail options, which turn the lobby into a revenue generator.

Guest rooms are changing shape **-** Guest rooms are getting wider, squarer, and more functional. The traditional rectangular hotel room measured 13×29 net feet; now rooms are expanding to 16 or 17 feet wide but are getting shallower. The double-queen-bed guest room in Starwood's Aloft brand, for example, measures 18 feet, 6 inches × 17 feet, 6 inches, while Hyatt Place king-bed guest room is slightly larger at 18 feet × 18 feet, 4 inches.

Squared-off rooms have slightly less square footage—averaging around 350 square feet versus the more typical 375–425 square feet—but they better utilize their space and feel larger. They also allow for larger bathrooms. Expansive glazing and higher ceilings—nine feet versus the standard eight—also add to the sense of space. The resized rooms are influenced by Asian and European hotels, such as removing the armoire and installing flat-screen TVs, which result in square footage gains.

Guest rooms are also becoming more business-friendly because most people who travel with laptops still want the option to work in their rooms, even when there is a nice new multipurpose lobby downstairs. Bigger desks and increased workspace are critical, as are extra outlets placed higher on the wall so guests don't have to crawl around on the floor looking for connections. Internet access—either hardwired or Wi-Fi—is the rule, not the exception.

Forget the bathtub - think "super shower" **-** There was a time when guests felt they were being cheated if their hotel room didn't have a bathtub. That time has passed. A lot of hotels are being built without bathtubs because people don't use them. A three-foot-by-five-foot shower—about the space a bathtub would occupy—is quite generous, but guests want more than elbow room if they are to fully embrace the shower-only option. More tile and glass finishes are being added to bathrooms to enhance color and interest. Other trends include better lighting (such as cove lighting) and shower upgrades such as larger or multiple showerheads.

Manage the energy budget more closely **-** Rising energy costs are forcing American hotels to finally adopt technology that requires guests to use hotel keys to activate their room's lights and HVAC—something routinely done in foreign market hotels. With soaring energy costs and equipment becoming less expensive, the time has come.

Another energy-saver is the ability to monitor and control temperature in all the guest rooms from a central point; hotel staff can remotely raise or lower thermostat settings. More-efficient lighting outside the guest room suggests putting hallway lights on motion sensors.

Consider check-in kiosks **-** Self check-in/check-out kiosks will be a mainstay in hotels at all price points, allowing guests to avoid the front desk and quickly get into or out of their rooms. The front desk, however, will never completely disappear, even with lobbies becoming so much more than places to check in or out. Older travelers almost always prefer to see a human being at the front desk, while younger travelers will almost always go to the kiosk first. No matter the traveler's age, there will always be a need for front desk staff should problems/questions arise.

General Overview of the U.S. Convention & Meetings Market

Full-service meeting hotels rely on group events for a portion of their business. Given the nature of the Frederick economy and growing needs for full-service meeting/banquet space, this section outlines key trends in the convention/meeting industry.

Over the last 20 years, the U.S. convention and meetings market experienced tremendous growth in the supply of exhibit and meeting space through both new construction and expansion. This increased supply led to a more competitive marketplace where numerous facilities can accommodate meeting planners' needs strictly in terms of the amount of space required. The increase in supply combined with broader economic conditions such as higher unemployment, increased costs associated with travel and lower corporate returns has resulted in a downward trend in overall demand for convention and meeting space in recent years. However, the current environment provides an edge to those facilities located in destinations offering an attractive amenities package and proximate to a broad industry base of conventions and meetings hosted for a variety of geographic segments (i.e., State, regional or national).

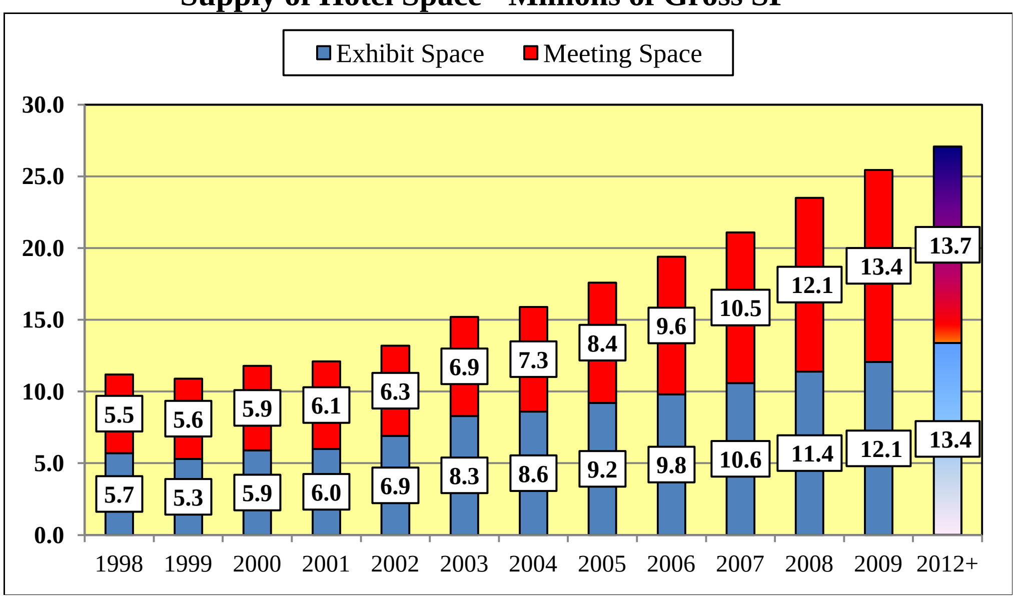
As a point of reference, the following table illustrates the site selection criteria that meeting planners considered very important and their relative ranking by type of event.

Decision Factors Considered "Very Important"				
Factor	Corporate Meetings	Corporate Incentives	Association Conventions	Association Meetings
Availability of hotels or other facilities suitable for meetings	78%	62%	84%	68%
Affordability of destination	77%	55%	79%	77%
Safety and security of destination	62%	77%	65%	62%
Ease of transporting attendees to/from location	61%	54%	50%	45%
Distance traveled by attendees	58%	36%	50%	53%
Transportation costs	48%	41%	36%	40%
Clean and unspoiled environment of destination	37%	59%	29%	26%
Climate	33%	73%	19%	17%
Mandated by corporate policy	26%	22%	24%	22%
Availability of recreational facilities such as golf, swimming, tennis, etc.	21%	70%	10%	10%
Sightseeing, cultural or other extracurricular attractions	15%	66%	16%	10%
Glamorous or popular image of location	12%	59%	10%	10%

Source: *Meetings & Conventions.*

There has been a supply boom in hotel meeting and exhibit space. As shown in the following graph, hotel function space in the U.S. has more than doubled from approximately 11.2 million in 1998 to 25.5 million in 2009. This development primarily took place in Las Vegas and other resort-type, all-inclusive properties such as those operated by Gaylord Hotels. Consequently, a growing number of hotels are able to directly compete with exhibition/convention facilities.

Supply of Hotel Space - Millions of Gross SF



Source: *Tradeshow Week.*

Perhaps more importantly, hotels with exhibit space can have an advantage over convention centers because they control all major components of an event (i.e. function space, lodging and food/beverage) under one roof. Since the hotel is the primary beneficiary of all revenue streams, it can negotiate packages as it sees fit in any or all areas to attract business. For instance, a hotel can offer meeting and/or exhibit space for free or at a deeply discounted rate because it would still receive revenue from the rooms and food service which is often more profitable. In addition, some privately operated hotels offer entertainment (i.e. a headliner act for a banquet) as part of their overall package to entice meeting planners. Many of these properties are situated in suburban locations, remote from other businesses that might attract some of the attendee spending away from the hotel's internal revenue generators.

Meeting Professionals International (MPI) conducts an annual survey (*Future Watch*) to gather key facts and comment on meeting industry trends. *Future Watch* also reports that many meeting professionals have changed the formats of their large events by splitting them into smaller, regional events. In doing so, cost savings can be realized and this strategic site selection has improved attendance.

MPI's survey respondents also report that more meeting professionals are demanding innovative technology. Continued focus on efficiency has caused meeting planners to explore virtual meeting technology, budget tracking software, smart phone applications, social media, delegate tracking and polling tools that can help them achieve event goals and report ROI. This increased interest in technology will likely require educational seminars about product use and application going forward. The scope of event technology is also expanding to include pre- and post-event as well as during the meeting itself. Increasingly, delegates and speakers are demanding more technological tools and continual access during meetings via social media, multi-media presentations, and audience interactivity tools. Eighty-eight percent (88%) of meeting professionals surveyed say that new technology solutions will directly affect the future of meetings and events.

According to the *2011 State & Regional Associations of the U.S. and National Trade and Professional Associations of the U.S.*, there are 613 associations headquartered in Maryland. Frederick is proximate to nearly 3,500 associations that are headquartered in Maryland, D.C., Virginia, Delaware and Pennsylvania. These account for 21% of all associations headquartered in the U.S. These associations represent a target market within the State and region for annual conventions, tradeshows and smaller division meetings in addition to meeting and banquet activity for area businesses, government agencies and residents.

Distribution of Association Headquarters

State	State/ Regional Associations	National Associations	Total
Virginia	242	925	1,167
D.C.	60	1,082	1,142
Maryland	192	421	613
Pennsylvania	260	228	488
Delaware	60	14	74
Total	**814**	**2,670**	**3,484**

Source: Associations of the United States, 2011.

Trends in Hotel Construction-Going Green

Green building remains a new-hotel construction objective but only a small portion of proposed hotels are being developed to meet LEED certifications. New construction is primarily emphasizing more efficient energy system design and operations rather than the wholesale use of green building materials and construction methods. Some hotels are going to great lengths to "green up" their hotel properties. Element, a member of Starwood Hotels & Resorts was the first chain to receive a LEED-certified gold rating, the second-highest standard bestowed on a building by the United States Green Building Council (USGBC).

The additional cost of going green may deter some hotels. Gold LEED certification is approximately a nominal premium above the total cost of the building. Initial construction costs can often be offset from the operational side over the course of three to five years.

Energy savings include keeping electricity down to a minimum through natural lights and the use of CFL bulbs, low-flow showers and dual-flush toilets that save water, and a roofing material that reflects heat from the sun. Keeping with LEED standards, some properties also purchase wind energy.

Most national hotels have LEED certification programs. Specifically, Marriott's LEED Volume program claims to be a cost-effective solution to going green. Specific benefits in their program are as follows:

- 15% - 20% reduction in energy consumption (from current ASHRAE codes)
- 10% - 20% reduction in water consumption generated from state-of-the art fixtures in water closets, showers and lavatories
- An increase in efficiency within the building's walls, roof and windows
- Lighting controls, including LED lighting, low-mercury content florescent lamps, occupancy sensors, daylight controls, and time clocks reduce energy consumption

Trends in Hotel Development Costs

HVS performs an annual survey of hotel development costs which is national in nature. As illustrated below, the median cost per room for a full-service hotel decreased slightly between 2008 and 2010 which is likely due to the recent recession.

Hotel Development Cost Survey
Full-Service Hotels - Median Values Per Room

Year	Building and Improvements	Soft Costs	FF&E	Pre-Opening	Total
2008	$121,600	$16,200	$20,000	$6,100	**$163,900**
2010	$122,900	$14,000	$18,100	$5,700	**$160,700**

Source: HVS International.

Although not shown above, the greatest impact in development cost in recent years has been the land component.

During the prior lending cycle, land was a major form of collateral for construction lending and the price of well-located sites increased precipitously. In challenging real-estate investment periods land is often the development component that experiences the greatest decline. A 2010 publication of the Federal Reserve that analyzed land prices in 23 metropolitan statistical areas across the U.S. described composite residential and commercial land prices increasing nearly 130% from 2002 to the second half of 2007. From the peak in 2007, land prices have decreased by more than 40%. The evidence of hotel land value declines is often more anecdotal than based on market evidence. In recent years, there have been relatively few land transactions as owners withdraw property from the market and hold on to sites, waiting for a time when development will once again generate positive financial returns.

In the past few years, furniture, fixtures and equipment (FF&E) costs have decreased as purchasing agents have negotiated substantial discounts with vendors on many items. Other FF&E costs have not been as impacted; the costs of wood furniture and fabrics have remained high.

General Program Parameters and Potential Site Options

The program parameters for the proposed new hotel are important elements in terms of its marketability and competitive position as they are key drivers of the associated cost, operating characteristics and site requirements. While the scope of this study did not include a site analysis, this report comments on the general marketability of sites previously identified by the City/County as potential locations for the proposed new hotel.

General Program Parameters

Consistent with the Pinnacle/OPX report, it is recommended that the proposed hotel offer 200 guest rooms in a full-service, branded property in downtown Frederick. Given recent design trends, it is also recommended that guest rooms be a minimum of 325 to 350 square feet to ensure long-term flexibility among the major hotel brands.

Recommended Services and Amenities

The operating environment for the proposed hotel and the services and amenities offered by the competitive set will influence the programming for the property. Based on industry trends and the current programming offerings in the market, it is recommended that the proposed hotel include the following services and amenities:

Fitness Center that features free-weights, cardiovascular equipment, treadmills with personal TV monitors, yoga mats and exercise balls. Fitness center access should be 24 hours, 7 days a week.

Business Center that includes 24-hour access; offer Macintosh and IBM computers, high-speed internet access, copying, printing, scanning and faxing.

Wi-Fi Connectivity that is available throughout the proposed hotel. Most of the competitors in the market currently offer complimentary Wi-Fi service.

Swimming Pool that includes heated indoor or outdoor pool and spa.

In-Room Amenities should seek to include the following:

- In-Room Movies
- 32”-42” Plasma or LCD Television
- MP3 Player Hook-Up
- Signature Bedding
- Down Pillows
- Higher Thread Count Cotton Blend Linens
- Pillow-Top Mattress
- Alarm/Clock Radio
- Dual-Line Speaker Telephone
- Coffee Maker
- Iron and Ironing Board
- Oversized Desk
- Upgraded or Signature Showerhead

Food and Beverage

The following on-site food and beverage facilities are recommended for the proposed hotel:

- *Casual Restaurant and Lounge* - A 60 to 80 seat casual dining restaurant and lounge should be open for breakfast and dinner. The restaurant should be physically positioned to take advantage of the views of downtown Frederick.
- *Pantry*- A pantry offering an assortment of drinks, snacks and incidentals for purchase.
- *Room Service* - Room service should be offered for breakfast and dinner to hotel guests.

Meeting/Banquet Space

The appropriate amount and configuration of meeting/banquet space is typically dependent on and driven by demand - more specifically, the ability to satisfy a niche not currently accommodated in the market. The Holiday Inn Hotel and Conference Center in Frederick, which offers nearly 14,000 square feet of meeting space, is the predominate property in the market. The Lynfield Event Complex hosted a variety of social functions and fundraisers prior to being sold and converted to a church.

As mentioned previously, market research indicates that there is currently unmet market demand for higher end meeting/banquet space in Frederick due to the quality, availability and/or configuration of existing space. As a meeting and an event destination, the proposed hotel appeal will be greater if it is branded by a major hotel company, as some groups will be more likely to host an event or meeting at a branded property.

Given the anticipated size of the property, recommended facilities and amenities, as well as the operating environment, it is recommended the proposed hotel offer approximately 14,000 to 15,000 square feet of meeting space. This figure represents only useable function space, net of necessary support space. The suggested configuration would include a ballroom ranging from 5,000 to 6,000 square feet of function space with flexible divisibility into five sections. These general parameters are consistent with the Pinnacle/OPX study. The following table shows seating capacities for different room layout configurations.

Ballroom Seating Configurations for the Proposed Full-Service Hotel - Downtown Frederick

Configuration	5,000 SF	6,000 SF
Banquet	400	500
Theater	500	600
Reception	530	650
Schoolroom	320	380

Source: HGS.

In addition, programming of the meeting space should include two-1,500 square foot rooms, both divisible by two. The remaining 6,000 to 7,000 square feet of meeting space should include 2,000 square feet of pre-function space, while the remaining square footage should be allocated among several individual meeting rooms ranging in size from 300 to 750 square feet.
While the total amount of recommended function space at the proposed property is similar to that currently offered by the Holiday Inn Hotel & Conference Center, the finishes, amenities and price point should differentiate the target market and allow the City to attract incremental new meeting/banquet business.

Supporting Ancillary and Retail Components

If the construction budget and space allocation allows, the development of this downtown full-service property in downtown Frederick should consider including complementary and supporting ancillary retail components. Given the potential captive audience of business professionals and social events to which the proposed hotel would likely cater to, the following potential retailers/tenants may want to be considered as part of the development.

- Hair/Nail Salon
- FedEx Office Kinko's
- Car Rental
- Florist
- Photographer
- Wedding Planner
- Jewelry Store

Any ancillary and retail components should be market-driven and take into account the location characteristics of the chosen site.

Potential Site Options

The client group has identified several potential sites in downtown Frederick for the proposed new hotel. In the previous study, the amount of building square footage for the various sites ranged from 129,000 square feet to 160,000 square feet. Of the six square footage estimates, five were based on 225 guestrooms and one was based on 185 guestrooms. Our findings and facility recommendations include a few more amenities and slightly larger guestrooms. Therefore, the required square footage for the proposed full-service hotel is on the higher end of the previously stated range. Potential sites were previously determined to be sufficient in terms of size, each with its own unique attributes. However, no priority has yet been determined.

The following conceptual site plans prepared by Pinnacle/OPX identify, in general terms, six potential locations:

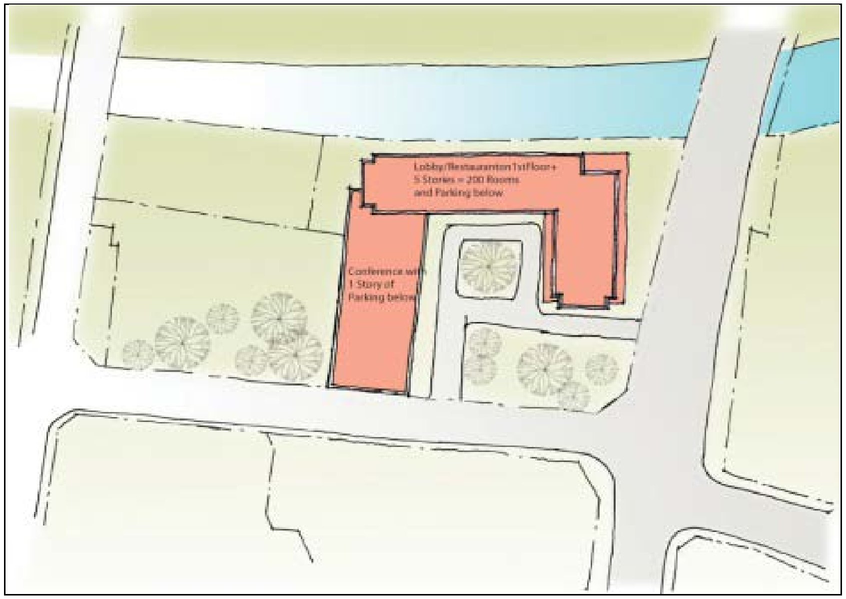
Corner of South & East Streets

Source: Pinnacle/OPX.

Potomac Edison Power Location - East Patrick Street

Source: Pinnacle/OPX.

All Saints & East Street, Next to Delaplaine



Source: Pinnacle/OPX.

Parking Lot Behind MARC Train Station

Source: Pinnacle/OPX.

USPS Site – East Patrick Street

Source: Pinnacle/OPX.

200 East Patrick Street - Former FNP Location

Source: Pinnacle/OPX.

Assuming that the majority of hotel-related business will be drive-in, primary considerations when selecting the site should include ingress/egress to and from the property, availability of on-site and nearby parking as well as proximity to downtown amenities such as restaurants and shopping.

Although our scope of work does not include commenting on a preferred site location for the proposed new hotel, the following guiding principles should be considered in the ultimate site selection process:

- *Accessibility* - The selected site should have relatively straightforward access to Interstate 70 as well as some of the major thoroughfares in downtown Frederick

- *Visibility* – The property should be visible from East Street.

- *Proximity* – Walking distance to the center of downtown Frederick (less than ¼ mile), retail and restaurant establishment, Carroll Creek Park and Transit Center

- *Parking* - In addition to the underground parking spaces included in the various site scenarios, access to additional parking proximate to the proposed hotel is a critical success factor for the development. Additional parking spaces will be necessary during peak times for larger meetings or special events at the proposed hotel.

- *Expansion Capability* – The site should offer space for future expansion, if necessary

During the course of our fieldwork, we toured the various potential sites for the proposed full-service hotel identified by the City/County. All of these sites were identified in the previous report and appear to be viable alternatives for the proposed hotel. The City/County also noted that there may be other sites within the downtown core which may be suitable for the proposed project.

Competitive/Comparable Analysis

In order to gain an understanding of the recent lodging market characteristics, it is important to define a relevant competitive set in the local economy as well as comparable properties in a similar setting (given the lack of a full-service property in the local area). This section of the report profiles these properties in terms of key operating characteristics.

Competitive Set Defined

The defined competitive set for the Frederick hotel market consists of eight properties totaling 948 rooms. All of the properties, with the exception of the Holiday Inn, are limited-service properties. The following chart illustrates Frederick's competitive hotel supply.

Competitive Hotel Market - Frederick, MD		
Property	**Number of Guest Rooms**	**Meeting/ Ballroom Space SF**
Holiday Inn Frederick Conference Center	155	14,000
Hampton Inn & Suites Fort Detrick	104	3,928
Hilton Garden Inn Frederick	143	2,016
Hampton Inn Frederick	161	1,800
Residence Inn Frederick	90	1,100
Holiday Inn Express Frederick	100	689
Marriott Courtyard Frederick	90	221
Fairfield Inn & Suites Frederick	105	n/a
Total	**948**	

Note: Sorted in descending order by SF of meeting/ballroom space.

Source: HGS.

Competitive Set – Market Demand Characteristics

During the course of our fieldwork, operating statistics for each property were obtained from Smith Travel Research. In addition, interviews were conducted with on-site management to discuss trends, market outlook, and proposed renovations to the existing competitive supply. The following table illustrates the historical supply and demand trends for Frederick hotel accommodations:

Historical Demand - Frederick Hotel Market				
Year	**Room Supply**	**Room Demand**	**Occupancy**	**Average Daily Room Rate**
2007	328,860	208,861	63.5%	$106.30
2008	346,020	231,773	67.0%	$105.22
2009	346,020	243,827	70.5%	$103.66
2010	346,020	229,289	66.3%	$106.12
2011	346,020	254,467	73.5%	$106.68

Sources: Smith Travel Research; HGS.

The Frederick hotel market experienced a downturn in occupancy levels in 2007 which was primarily attributable to the opening of the Hilton Garden Inn in May of that year. Since then, the Frederick hotel market has been relatively strong due to the expansion and growth of local companies, the expansion at Fort Detrick, and the increase in government related spending and contracts. Average daily room rates have remained relatively stagnant for the past five years. Average daily room rate suppression in the Frederick hotel market is likely due to the national recession as well as the significant amount of government demand in the market.

Competitive Set – New Addition to Supply

A 120-room Town Place Suites hotel by Marriott is currently under construction and is scheduled to open in the summer of 2012. A rendering of a typical Town Place Suites is adjacent. Town Place Suites are designed for the “do-it-yourself” extended-stay traveler. The property will feature studio, one and two bedroom suites with a fully-equipped kitchen, work space and high-speed internet. Town Place Suites, an extended stay property for the value-conscious guest, is rate positioned lower than the Residence Inn. Property amenities will include a complimentary continental breakfast, fitness center, pool and on-site laundry facilities. The new Town Place Suites Frederick will primarily compete with the other limited-service properties in the market.

Competitive Set – Market Demand Segmentation and Growth

Lodging demand is typically comprised of several market segments. These segments and their typical characteristics are outlined in this section.

Commercial Individual Demand

Commercial demand consists mainly of individual business people passing through the market or visiting area businesses in addition to high-volume corporate account travelers generated by local firms. Brand loyalty (particularly frequent-traveler programs) as well as location and convenience with respect to businesses and amenities influence lodging choices in this market segment. Companies typically designate hotels as ‘preferred” accommodations in return for more favorable rates, which are discounted in proportion to the number of room nights produced by a commercial client. Commercial demand is strongest Monday through Thursday nights, declines significantly on Friday and Saturday, and increases somewhat on Sunday night. It is relatively constant throughout the year, with marginal declines in late December and other holiday periods.

The local commercial segment consists of demand associated with government contractors, a strong healthcare and medical industry, and a wealth of bio-tech companies located within the Frederick area. The growing financial and healthcare sectors should boost demand generated by this segment in the coming years. Companies such as State Farm, Wells Fargo, and the Frederick National Laboratory for Cancer Research play an important role in this segment.

Group Demand

The group demand market segment includes meetings, seminars, association meetings and similar gatherings of ten or more people. Although there are numerous classifications with the group segment, the primary categories considered in this analysis are corporate groups, associations, and SMERF (i.e., social, military, educational, ethnic, religious and fraternal). Corporate groups typically meet during the business week. These groups tend to be the most profitable for hotels as they typically pay higher rates and usually generate ancillary revenues including food, beverage, and banquet revenue. SMERF groups are typically price-sensitive and tend to meet on weekends and/or during the summer months or holiday season when greater discounts are available. The profile and revenue of associations varies depending on the group and the purpose of their meeting or event. The group demand in this segment is driven by local corporate entities, government, and leisure groups as well as special interest groups and social events such as weddings.

Leisure Demand

Leisure demand consists of individuals and families spending time in an area with the travel purpose being sightseeing in historic downtown Frederick, shopping, dining or visiting friends and relatives. Leisure demand also includes room nights booked through internet sites such as hotels.com and Priceline; however leisure may not be the purpose of the stay. This demand may also include business travelers and group attendees who use these channels to take advantage of any discounts that may be available on these sites. Leisure demand is typically strong on Friday and Saturday nights and the summer months. These peak periods represent the inverse of commercial visitation trends, underscoring the stabilizing effect of capturing weekend and summer tourist travel. Future leisure demand is related to the overall economic health of the region and the nation. Trends showing changes in state and regional unemployment and disposable personal income correlate strongly with leisure travel trends. Leisure demand in the area is primarily generated by historic downtown Frederick and its amenities. Leisure demand is the highest during spring and summer months.

Government Demand

This market segment primarily consists of government officials visiting Fort Detrick and Frederick National Laboratory for Cancer Research/Science Applications International Corporation (SAIC)-Frederick. Other sources of demand within this segment include contractors associated with Fort Detrick or Bechtel. Characteristics associated with the government sector include required usage of the government per diem average daily room rate and proximity to their destination. Given the continual expansion of Fort Detrick, this segment is expected to grow in future years.

Based on interviews with management of the competitive properties to determine their source of demand, the following table illustrates 2011 market segmentation for the competitive set.

2011 Competitive Set Mix of Demand		
Demand Segment	**Room Nights**	**Percent of Total**
Leisure	42,233	17%
Group	51,648	20%
Government	71,306	28%
Commercial Individual	88,975	35%
Total	**254,162**	**100%**

Source: HGS.

Factors Impacting Rate

Occupancy and average daily room rate are the primary drivers of hotel operations. The proposed hotel in Frederick will be unique in the local market given its service level and brand. As such, a comparison of rates at Annapolis full-service properties was conducted to understand the possible premium over existing local rates. In addition, Frederick has significant employment in the government sector which will play a role in the proposed property's market mix and resulting room rate. Government per diems for Frederick and surrounding areas are compared here to understand this unique segment.

<u>Comparable Set – Rate Differential</u>

In order to validate the average daily room rate premium for a full-service property, the actual achieved results of limited-service and full-service hotels in Annapolis were analyzed. The achieved results for these two types of hotels and the corresponding average daily room rate differential are shown in the following table.

Average Daily Room Rate Differential Limited-Service vs. Full-Service Hotels in Annapolis, MD			
Year	**Limited-Service ADR**	**Full-Service ADR**	**Difference**
2008	$114.64	$155.55	$40.91
2009	$104.85	$136.09	$31.24
2010	$105.04	$138.25	$33.21
2011	$107.67	$140.41	$32.74

Sources: Smith Travel Research; HGS.

The base year for our analysis of average daily room rates is 2011. As illustrated above, the achieved rate for the limited service hotels in Annapolis is virtually the same as the historical average rates achieved in the Frederick market. In addition, both markets have a substantive amount of government demand.

Area Government Per Diem Rates

The Frederick hotel market has a substantive amount of government and government-related business that is priced at prevailing per diem rates. Historically, this has been a challenge for the Frederick market in achieving average daily room rate growth. The following chart illustrates the lodging per diem rates for Frederick County and the adjacent Counties of Montgomery and Howard.

Per Diem Rates for Select Maryland Counties

Month/Year	Frederick	Montgomery	Howard
October 2011	$95	$226	$105
November 2011	$95	$183	$105
December 2011	$95	$183	$105
January 2012	$95	$183	$105
February 2012	$95	$224	$105
March 2012	$95	$224	$105
April 2012	$95	$224	$105
May 2012	$95	$224	$105
June 2012	$95	$224	$105
July 2012	$95	$224	$105
August 2012	$95	$169	$105
September 2012	$95	$169	$105

Source: U.S. General Services Administration.

Despite their proximity, the disparity between the government per diem rates for Frederick and Montgomery Counties is significant. Annual per diem rates are established by the State and the U.S General Services Administration. If the per diem rates for Frederick County were adjusted, the opportunity for the local hotel market to achieve higher average daily room rates would substantially improve.

Comparison of Market Demand

Future performance estimates for the proposed new hotel are based on several factors including an analysis of historical trends in market performance, recent and current trends influencing potential market demand generators, regional tourist and traffic volume and new supply growth. The most significant of these is the continued growth in the County and State economies as it relates to population, employment, commercial and government sector growth.

Market Demand Assumptions
Key assumptions used in the market demand analysis include, but are not limited to, the following:

- The proposed new hotel is privately owned and operated.
- The proposed new hotel is estimated to open in January 2016 and will represent 16% of the competitive room supply assuming there are no new additions other than that noted previously.
- The property will be well-located in downtown Frederick, a pedestrian friendly, mixed-use environment that is unique relative to the other hotels in the competitive set.
- The proposed hotel will be the only full-service property in the competitive market.
- The hotel will be branded and enable the property to achieve strong market share from the brand central reservation system (CRS), national sales office leads and frequent traveler program.
- The hotel will be developed, designed and furnished with typical full-service offerings and amenities.
- The hotel's building program will increase the availability and flexibility of meeting/banquet space to accommodate incremental new demand in the community.
- The proposed hotel is assumed to be competently managed, aggressively marketed and will maintain high levels of service.
- No significant economic downturn occurs within the projection period.
- No major terrorist events or wars occur that have a material adverse impact on local travel volume or homeland security.

Comparison of Demand Characteristics

A comparison of key demand characteristics of the proposed new full-service hotel is provided in the following table. Pinnacle/OPX assumed stabilization in year 3 whereas HGS assumes year 4. Although both studies assume 72% occupancy at stabilization, HGS estimates a 21% lower overall ADR due, in part, to the change in projected market mix. HGS estimates less leisure, group and commercial individual demand and more government related demand based on the updated market research.

Comparison of Demand Characteristics - Stabilized Year

Category	Pinnacle/OPX	HGS	Amount Difference	Percent Difference
Total Rooms	200	200		
Stabilized Year	Year 3 - 2016	Year 4 - 2019		
Market Mix				
Leisure	10,016	7,884	(2,132)	-21%
Group	17,179	16,294	(885)	-5%
Government	3,259	8,935	5,676	174%
Commercial Individual	22,122	19,447	(2,675)	-12%
Total Room Nights	**52,576**	**52,560**	**(16)**	**0%**
Occupancy	72%	72%	0%	0%
Average Daily Rate (ADR) - 2011 $	$178	$140	($38)	-21%

Sources: Pinnacle/OPX; HGS.

Demand for the proposed hotel is projected to be derived from a combination of future hotel market growth, the ability to accommodate historically unmet demand as well as incremental new demand induced by the proposed property itself. The Frederick market is anticipated to experience future growth that will account for a portion of room night demand at the proposed hotel. This anticipated future growth will also aid in absorbing the proposed full-service hotel in the market and growing overall market occupancy levels. Historically unaccommodated demand reflects potential room night demand that has not been realized by the existing competitive supply. Induced demand represents the additional room nights that are expected to be attracted to the market following the introduction of the proposed full-service hotel in downtown.

The remainder of this section provides supporting detail associated with the estimated demand characteristics.

Estimated Market Penetration

In formulating estimates of the proposed new hotel's position in the competitive market, its fair market share and potential ability to penetrate the market are both considered. Fair market share is defined as the percentage of demand allocated to a given property based on its ratio of available guestrooms to the total number of rooms in the competitive supply. Market penetration is defined as the percentage of fair market share demand allocated to a property on the basis of its competitive characteristics such as location, appearance, management expertise, physical condition, marketing orientation, rate structure, age, brand affiliation, reputation, size, facilities and amenities. A factor indicating that a property will possess competitive advantages suggests a market penetration in excess of 100% of fair market share, while competitive disadvantages are reflected in penetration rates of less than 100%.

The occupancy of the proposed new hotel is expected to be 53% in the first year of operation increasing to a stabilized level of 72% in the fourth year of operation. In a stabilized year of operation, the proposed hotel is projected to penetrate 115% of its fair share of commercial individual demand, 165% of group demand, 110% of leisure demand and 65% of government demand.

The following chart illustrates the differences in penetration rates between the two studies.

Market Penetration Comparison in a Stabilized Year for the Proposed Full-Service Hotel - Downtown Frederick

Demand Segment	Pinnacle/OPX	HGS
Commercial Individual	120%	115%
Group	143%	165%
Leisure	113%	110%
Government	25%	65%
Overall Penetration Rate	**103%**	**110%**

Sources: Pinnacle/OPX; HGS.

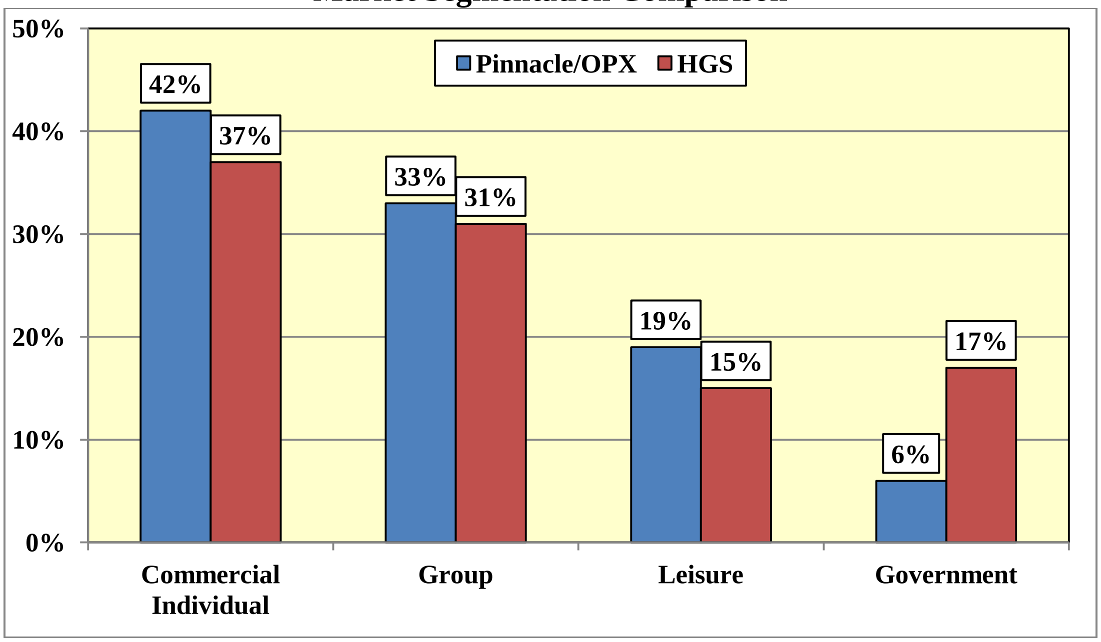
In general, the estimated penetration rates by market segment are relatively similar for commercial individual and leisure. The primary differences in penetration rates are in the group and government market segments. Considering both the current and historical trends, this analysis estimates that demand will increase at a rate of 2% from 2012 through 2015 and 1.5% annually for the remainder of the projection period. Group demand is estimated to increase at an annual rate of 1% throughout the projection period. The leisure segment is estimated to increase at an annual rate of 1% throughout the projection period. Government demand is estimated to increase by 2% for 2012 and 2013 and at an annual rate of 1% for the remainder of the projection period. Our demand interviews, the proposed amount of meeting space and the local dynamics of the Frederick hotel market suggest the proposed hotel will be able to penetrate group demand at 165% of its fair share in the fourth year of operation.

In addition, the government market segment accounts for 28% of the current overall demand in the Frederick hotel market and this segment is estimated to grow and be able to induce demand subsequent to the opening of the proposed hotel. The previous report estimated that 13,100 government-related room nights would be induced into the market, although the penetration analysis has the government sector at 25% of its fair share in a stabilized year of operation. This equates to approximately 3,259 room nights that would be accommodated by the government demand sector at the proposed hotel. Despite the impact that lower per diem rates have on the Frederick hotel market, our research indicates the government related business would be group orientated and utilize the meeting space at the proposed hotel. Given the recommended amount of meeting space at the proposed hotel, government penetration rates are estimated to be 65% in a stabilized year of operation, which would equate to approximately 8,900 total government related room nights in a stabilized year of operation.

Estimated Market Segmentation

The result of the penetration analysis yields the following estimated market segmentation for the proposed hotel.

Market Segmentation Comparison



Sources: Pinnacle/OPX; HGS.

As previously described, the revised estimates of commercial individual, group and leisure demand are lower than the Pinnacle/OPX estimates whereas government represents a higher percentage of the overall proposed hotel's market mix in the revised estimate.

Estimated Average Daily Room Rate

In the Pinnacle/OPX study, the estimated average daily room rate for the proposed hotel was based on the following:

- Year-end 2008 data.
- Interviews with demand generators indicating that they would be willing to pay a $70 premium a night for an upscale hotel in downtown Frederick.
- The achieved rates at each of the hotels in the competitive set, comparison to national averages of branded full-service hotels such as Marriott, Hilton, Westin and Hyatt which resulted in the application of a $30 premium for a full-service hotel versus a select or limited-service property.
- Average daily room rate in each market segment was analyzed and multiplied by the segment's market mix. The estimated overall average daily room rate was then calculated by adding the weighted average rates for each of the four demand segments in the market area.
- Average daily room rate growth was based on the CPI index of 3% annually which was applied to the base year rate of $163 throughout the projection period.

Our analysis and revised estimate of average daily room rates for the proposed hotel are based on the following:

- Year-end 2011 data.
- Interviews with demand generators indicating that they would be willing to pay a $30 premium per night for an upscale hotel in downtown Frederick.
- Interviews with representatives at various national hotel brands who confirmed interest in potentially developing a proposed new 200-room full-service hotel in downtown Frederick.
- Our analysis included analyzing the achieved rate in the Frederick competitive hotel set to a regional market within the State of Maryland, rather than national averages. In addition, we compared the actual achieved average daily room rates for full-service hotels versus limited-service hotels in the regional market within the State.
- We also analyzed average daily room rate in each market segment and multiplied by the segment's market mix. The estimated overall average daily room rate was then calculated by adding the weighted average rates for each of the four demand segments in the market area.
- After determining the base year average daily room rate for 2011, a CPI index of 2.7% was applied throughout the projection period based on historical inflation rates for the area over the past five years.

The following table compares the two sets of analyses for a stabilized year of operations.

Average Daily Room Rate Comparison - Stabilized Year Proposed Full-Service Hotel - Downtown Frederick				
Demand Segment	**Pinnacle/OPX 2011 $**	**HGS 2011 $**	**Amount Difference**	**Percent Difference**
Commercial Individual	$195	$160	($35)	-18%
Group	$162	$145	($17)	-11%
Leisure	$184	$125	($59)	-32%
Government	$92	$92	$0	0%
Overall	**$175**	**$140**	**($35)**	**-20%**

Sources: Pinnacle/OPX; HGS.

As shown, the revised estimates of ADR are lower in each demand segment except government. Overall ADR for the proposed hotel is estimated to be 20% lower than the Pinnacle/OPX study.

Comparison of Financial Operations

In the Pinnacle/OPX study, the following sources were used to estimate the potential financial operating results for the proposed full-service hotel:

- Smith Travel Research's 2009 HOST Report, data from year-end 2008
- Specific comparable property data of select properties with year-end results from 2005 through 2008

The revised estimate of financial operations in this analysis is based on the updated market research as well as actual operating results for full-service hotels in similar markets including those in the Annapolis market. Annapolis hotels used in this analysis were based on the following characteristics:

- All of the properties were nationally branded full-service properties
- Property size- sample set includes properties ranging from 150 to 256 rooms
- The market dynamics and demand patterns of the Annapolis and Frederick hotel markets

Because all of the properties in the sample set have been in operation for at least five years, they reflect stabilized operating results.

Summary of Financial Operations

This section outlines the estimate of income and expenses for the proposed hotel in downtown Frederick. It is anticipated that it will take four years for the property to reach a stabilized level of operation. Amounts are stated in 2011 dollars for comparison purposes.

The following table compares estimates of financial operations in a stabilized year. Although there are differences in individual line item estimates, the net operating income is relatively similar in both analyses.

Comparison of Estimated Financial Operations - Stabilized Year ($000s)				
Category	**Pinnacle/OPX Year 3 - 2016**	**HGS Year 4 - 2019**	**Amount Difference**	**Percent Difference**
Operating Revenues				
Room	$9,348	$7,361	($1,987)	-21%
Food/Beverage	5,917	2,875	(3,042)	-51%
Telephone		35	35	
Other	905	460	(445)	-49%
Total	16,170	10,731	(5,440)	-34%
Operating Expenses				
Room	2,011	1,403	(608)	-30%
Food/Beverage	4,260	2,013	(2,248)	-53%
Telephone	653	36	(617)	-94%
Administrative and General	1,453	707	(746)	-51%
Marketing	1,639	788	(851)	-52%
Property Operations and Maintenance	568	578	9	2%
Energy	677	560	(117)	-17%
Management Fee	485	322	(163)	-34%
Total	11,747	6,407	(5,340)	-45%
Non-Operating Expenses				
Property Taxes	590	694	104	18%
Insurance	142	83	(59)	-42%
Reserve for Replacement	647	429	(218)	-34%
Total	1,379	1,206	(173)	-13%
Net Operating Income	**$3,044**	**$3,117**	**$73**	**2%**

Notes: All amounts are shown in 2011 dollars.
Other revenues in the Pinnacle/OPX study include telephone charges.

Sources: Pinnacle/OPX; HGS.

The table above reflects the estimate of income and expense for the proposed hotel. It is assumed that the property would be built with the recommended facilities listed herein and will be a first-class, full-service hotel in nature and be branded as such. A net income ratio of 29.1% is estimated for a stabilized year of operation.

Operating Revenues - Summary of Significant Assumptions

Room Revenue is determined by two variables: occupancy levels and average daily room rate. As stated in the previous section of this report, the proposed property is expected to stabilize at an occupancy level of 72% in the fourth year of operation with an average daily room rate of $140 (in 2011 dollars). Due to the differences in projected demand segmentation from the Pinnacle/OPX study, the revised ADR estimate is 20% lower.

Food and Beverage Revenue is generated by a hotel's restaurant, lounge, food and beverage operations for the banquet and meeting space, meeting room rental income and room service. In addition to providing a source of revenue, these outlets serve as an amenity that aids in driving guest room sales. It is expected that in-house guests will not contribute as much food and beverage revenue at the hotel's in-house restaurant as the comparable data set due to the plethora of restaurant options in downtown Frederick. Conversely, the banquet and social related food and beverage revenues are assumed to exceed the comparable set. There are relatively few options for social functions and banquets in the greater Frederick market area. As stated previously, the Lynfield Event Center, which had two 5,600 square foot banquet rooms and catered to weddings, graduations and other social/special events, was recently sold and re-purposed. Food and beverage revenues per occupied room are estimated to be $55 (in 2011 dollars) in the stabilized year of operation which is 51% lower than the Pinnacle/OPX estimate.

Telephone Revenue is generated by hotel guests who charge long distance calls to their rooms. With the continued proliferation of cell phones and other wireless communications media, telephone revenue levels are expected to be relatively flat. Telephone revenue per occupied room is estimated to be $0.66 in the stabilized year (in 2011 dollars). Telephone revenues were combined with other income in the Pinnacle/OPX study and are therefore not directly comparable.

Other Income is derived from sources other than guestrooms, food and beverage and telephone income such as retail, business services, in-room movies, cancellation fees, etc. Other income is estimated to be $8.75 per occupied room in a stabilized year. The proposed property's other income sources are expected to be generated primarily from the hotel's retail outlets, business center and in-room movie charges. This line item does not include parking in the revised estimate, and therefore, it is 49% lower than the Pinnacle/OPX study.

Operating Expenses – Summary of Significant Assumptions

Room Expenses consists of items related to the sale and maintenance of guestrooms and public space. Salaries, wages and employee benefits account for a substantial portion of this category. Although payroll varies somewhat with occupancy, much of the hotel's payroll is fixed. Front desk personnel, public area cleaners, housekeepers and supervisors must be maintained at all times. As a result, salaries, wages, and employee benefits are only moderately sensitive to changes in occupancy. Because commissions and reservations are based on room sales, they are sensitive to changes in occupancy and average rate whereas other operating expenses are only slightly affected by volume. Room expenses are estimated to stabilize at 19.1% of room revenue which is generally consistent with the 21.5% projected by the Pinnacle/OPX report.

Food and Beverage Expenses consist of items necessary for the primary operation of a hotel's food and beverage banquet facilities. The costs associated with food sales and payroll are moderately or highly correlated to food revenue. Items such as china, linen and uniforms are less dependent on volume. Although the other expense items are basically fixed, they represent a relatively insignificant factor, Beverage expenses consist of items necessary for the operation of a hotel's lounge and bar area. The costs associated with beverage sales and payroll are moderately to highly correlated to beverage revenues. Food/beverage expenses are estimated to stabilize at 70% of food/beverage revenue which is generally consistent with the 72% projected by the Pinnacle/OPX report. The food and beverage operations of the proposed hotel are expected to be efficiently managed and operate at an expense level that is in line with other comparable operations.

Telephone Expense consists of all costs associated with this department. The bulk of telephone expense consists of local and long-distance calls billed by the telephone companies that provide these services. With the decrease in telephone usage and revenues, the actual cost of calls has decreased. However, the labor costs associated with a dedicated switchboard staff remains in place, as the principal role of these individuals is to direct incoming calls and respond to and or direct calls from hotel guests. Consequently, in hotels with a dedicated switchboard staff, the profitability of the telephone department has decreased and, in many instances, these departments now operate at a loss. In properties, where these calls are handled by the front desk staff, profit levels have decreased, but most continue to generate a modest profit margin. Telephone expenses are estimated to stabilize at 105% of telephone revenue. As mentioned previously, telephone expenses were not projected separately in the Pinnacle/OPX report.

Administrative and General Expenses includes the salaries and wages of all administrative personnel who are not directly associated with a particular department. Expense items related to the management and operation of the property are also allocated to this category. Most administrative and general expenses are relatively fixed. Exceptions include cash overages and shortages, commissions on credit cards charges, provision for doubtful accounts, which are moderately affected by the number of transactions or total revenue, and salaries, wages, and benefits, which are very slightly influenced by volume. Administrative and general expenses are estimated to stabilize at 6.6% of total revenues which is lower than the 9.0% projected in the Pinnacle/OPX study.

Marketing Expenses consists of all costs associated with advertising, sales, and promotion – all of which are intended to attract and retain customers. Marketing can be used to create an image, develop customer awareness, and stimulate patronage of a property's various facilities. Most hotel companies establish an annual marketing budget that sets forth many of the planned expenditures. If the budget is followed, total marketing expenses can be projected accurately. Marketing expenditures are unusual because although there is a lag period before results are realized, the benefits often extend over a long period. Depending on the type and scope of the advertising and promotions program implemented, the lag time can be as short as a few weeks or as long as several years. However, the favorable results of an effective marketing campaign tend to linger and a property often enjoys the benefits of a concentrated sales effort for many months. Pinnacle/OPX projected marketing expenses would be 10.1% of total revenues in a stabilized year whereas our revised estimate stabilizes at 7.3%.

Property Operations and Maintenance is an expense category that is largely influenced or controlled by management. Except for repairs that are necessary to keep the facility open and prevent damage (e.g. plumbing, heating and electrical items) most maintenance can be deferred for varying lengths of time. Maintenance is an accumulating expense. If management elects to postpone performing a required repair, it has not eliminated or saved the expenditure just deferred payment until a later date. A lodging facility that operates with lower than normal maintenance budget is likely to accumulate a considerable amount of deferred maintenance. The age of a lodging facility has a strong influence on the required level of maintenance. A new or thoroughly renovated property is protected for several years by modern equipment and manufacturers' warranties. However, as a hotel ages, maintenance expenses escalate. A wellorganized preventative maintenance program often helps delay deterioration, but most facilities face higher property operations and maintenance costs each year regardless of the occupancy trend. The quality of initial materials and construction methods generally reduces the need for maintenance expenses over the long term. It is assumed the proposed property's maintenance operations to be well-managed and the expense levels will stabilize at 5.4% of total revenues which is slightly higher than the Pinnacle/OPX projection of 3.5%.

Energy consumption for a lodging facility includes, water, gas, electricity. Total energy costs depend on the source and quantity; electricity tends to be the most expensive source. Energy costs are estimated to stabilize at 5.2% of total revenue compared to the Pinnacle/OPX projection of 4.2%.

Management Fees consists of fees paid to the managing entity of the property. Some companies provide management services and a brand–name affiliation, while others provide management services alone. Some management contracts specify only a base fee (usually a percentage of total revenue), while others call for both a management fee and an incentive fee (usually a percentage of defined GOP or Net Operating Income). Basic hotel management fees are almost always based on a percentage of total revenue, which means they have no fixed component. While base fees typically range from 3% to 5% of total revenue, incentive fees are deal specific and are often calculated as a percentage of income available after debt service, and in some cases, after a preferred return on equity. Total management fees for the proposed property are estimated to stabilize at 3% of total revenue which is consistent with the Pinnacle/OPX projection.

Non-Operating Expenses – Summary of Significant Assumptions

Property Taxes - In Frederick City and County, the market value of real estate property is typically determined utilizing the cost approach to value. This analysis calculates property taxes based on the current assessed tax rates in Frederick County.

In addition, the City imposes a business personal property tax rate of 33 ½ % on the assessed depreciated value of business owned personal property. Personal property taxes are not estimated as part of this analysis but would generate additional benefits to the City.

Insurance consists of the cost of insuring the hotel and its contents against damage or destruction from fire, weather, sprinkler leakage, boiler explosion and so forth. General insurance costs also include premium relating to liability, fidelity and theft insurance. Insurance costs are based on many factors, including building design and construction, fire detection and extinguishing equipment, fire district distance and the area's fire experience. Insurance expenses do not vary with occupancy levels. Insurance expense is estimated to stabilize at 1% of total revenue which is consistent with the Pinnacle/OPX report.

Reserve for Replacement - Furniture, fixtures and equipment are essential to the operation of a lodging facility, and their quality often influences a property's class. This category includes all non-real estate items that are capitalized rather than expensed.

The furniture, fixtures and equipment of a hotel are exposed to heavy use and must be replaced at regular intervals. The useful life of these items is determined by their quality, durability, and the amount of guest traffic and use,

Periodic replacement of furniture, fixtures and equipment is essential to maintain the quality, image and income producing potential of a lodging facility. Because capitalized expenditures are not including in the operating statement but nevertheless affect an owner's cash flow, a forecast of income and expenses should reflect these expenses in the form of a reserve for replacement. Reserve for replacement is estimated to stabilize at 4% of total revenue which is consistent with the Pinnacle/OPX report.

Economic and Fiscal Impact Analysis

This section of the report estimates the economic and fiscal benefits that might accrue to Frederick as a result of pursuing the proposed new hotel. Market research suggests the new hotel, which is anticipated to be a higher-end property than those currently offered in Frederick, could benefit the City, County and State in a number of qualitative ways such as:

- Enhancing the area's image as a business, meetings and leisure destination.
- Receiving increased State and regional exposure through destination marketing and visitation.
- Providing a first-class meeting/banquet venue for area residents, business travelers and groups.
- Serving as a catalyst for further development initiatives in the area.
- Generating economic activity and fiscal revenues.

Each of these benefits is important in assessing the overall impacts of the proposed hotel. While the value of many of these benefits is difficult to measure, the economic and fiscal impacts generated can be quantified. As such, this analysis estimates the direct, indirect and induced economic benefits associated with the operations of the proposed hotel as well as the associated tax revenues.

General Methodology Overview

An assessment of the economic benefits that occur as a result of on-going operations of the proposed hotel can be approached in several ways. This analysis uses direct revenues from lodging, food and beverage, and other spending (e.g., telephone, rentals, equipment rental, etc.) generated from guest/event related activity at the proposed hotel as well as estimated guest spending outside the hotel on items such as retail, entertainment and transportation. Once the amount for direct spending is quantified, a calculated multiplier is applied to generate the indirect and induced effects. The sum of direct, indirect and induced effects equals total economic impact which is expressed in terms of spending (output), employment (jobs), and earnings.

This analysis also estimates the fiscal impacts generated from on-going operations of the proposed hotel. The governmental entities considered in this fiscal analysis are Frederick County and the State of Maryland. Revenues generated from corporate income tax, hotel/motel tax, personal income tax, motor vehicle rental tax as well as sales and use tax were estimated.

The number of room nights, distribution by market segment, financial operations, industry trends, economic conditions, direct spending categories used, per room night spending amounts, distribution of spending, multipliers, and specific taxes quantified are all variables that influence the economic and fiscal impact estimates.

Estimates are presented for a stabilized year of operations in both 2011 dollars (the latest year for which actual competitive set hotel operations were available) and 2019 dollars. All amounts are rounded to the nearest thousand.

Methodology – Economic Impact Analysis

Regional input-output models are typically used by economists as a tool to understand the flow of goods and services among regions and measure the complex interactions among them given an initial spending estimate.

Direct Spending

Estimating direct spending is the first step in calculating economic impact. Direct spending represents the initial change in spending that occurs as a direct result of proposed hotel operations. The spending quantified in this analysis relates to guest and event-related spending that occurs inside the hotel as well as guest spending outside the hotel at nearby businesses.

Indirect/Induced Impacts

The economic activity generated by proposed hotel operations affects more than just the property itself. In preparation for new spending in the economy, several other economic sectors are impacted and jobs are created. Indirect effects reflect the re-spending of the initial or direct expenditures or the business-to-business transactions required to satisfy the direct effect. Induced effects reflect changes in local spending on goods and services that result from income changes in the directly and indirectly affected industry sectors. The model generates estimates of these impacts through a series of relationships using local-level average wages, prices and transportation data, taking into account commute patterns and the relative interdependence of the economy on outside regions for goods and services.

Multiplier Effect

In an effort to quantify the inputs needed to produce the total output, economists have developed multiplier models. The estimation of multipliers relies on input-output models, a technique for quantifying interactions between firms, industries and social institutions within a local economy. This analysis uses IMPLAN software and databases which are developed under exclusive rights by the Minnesota IMPLAN Group, Inc. IMPLAN, which stands for Impact Analysis for Planning, is a computer software package that consists of procedures for estimating local input-output models and associated databases. The IMPLAN software package allows the estimation of the multiplier effects of changes in final demand for one industry on all other industries within a defined economic area. Its proprietary methodology includes a matrix of production and distribution data among all counties in the U.S. As such, the advantages of this model are that it is sensitive to both location and type of spending and has the ability to provide indirect/induced spending, employment and earnings information by specific industry category while taking into account the leakages associated with the purchase of certain goods and services outside the economy under consideration.

Once the direct spending amounts are assigned to a logical category, the IMPLAN model estimates the economic multiplier effects for each type of direct spending attracted to or retained in the economy resulting from the proposed hotel's operations.

Total Economic Impact

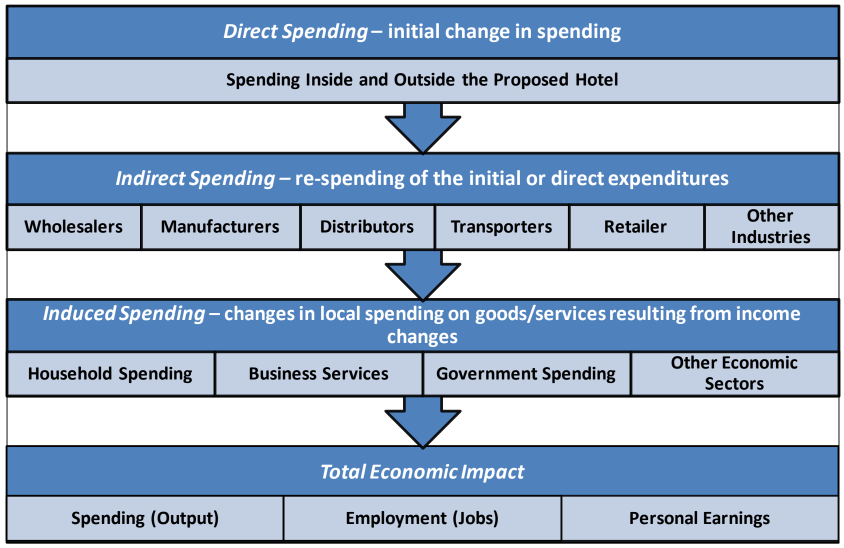
The calculated multiplier effect is then added to the direct impact to quantify the total economic impact in terms of spending, employment and earnings which are defined below:

- *Spending (output)* represents the total direct and indirect/induced spending effects generated by the proposed hotel's operations. This calculation measures the total dollar change in spending (output) that occurs in the local economy for each dollar of output delivered to final demand.

- *Personal earnings* represent the wages and salaries earned by employees of businesses associated with or impacted by the proposed hotel's operations. In other words, the multiplier measures the total dollar change in earnings of households employed by the affected industries for each additional dollar of output delivered to final demand.

- *Employment (jobs)* represents the number of full and part-time jobs supported by the proposed hotel's operations. The employment multiplier measures the total change in the number of jobs supported in the local economy for each additional $1.0 million of output delivered to final demand.

The following graphic illustrates the multiplier effects for calculating total economic impact.



Methodology - Fiscal Impact Analysis

The estimated spending generated by on-going operations of the proposed hotel creates tax revenues for the local jurisdictions and the State. Experience in other markets suggests that while a significant portion of the direct spending likely occurs near the hotel, additional spending occurs in other areas within the State, particularly spending on items such as business services and everyday living expense of residents. Various taxes that would be impacted by hotel operations were identified and taxable amounts to apply to each respective tax rate were estimated. Although other taxes (e.g., property taxes) may also be positively impacted by on-going hotel operations, this analysis estimates revenues generated from the following taxes based on the direct and indirect/induced spending amounts previously defined:

<u>Frederick County</u>

- Hotel/Motel Tax
- Local Personal Income Tax

<u>State of Maryland</u>

- Corporate Income Tax
- Motor Vehicle Rental Tax
- Personal Income Tax
- Sales and Use Tax

Our analysis is based on current tax rates. As such, any increase in tax rates would result in higher fiscal benefits.

Pinnacle/OPX Methodology – Economic & Fiscal Impacts

The Pinnacle/OPX report employed a different methodology to estimate direct spending. The major differences in methodology include the following:

- Direct spending includes operational revenues and a portion of expenses including payroll as well as associated taxes. The revised estimate does not include operational expenses but does account for out-of-hotel spending by guests. Despite a similar number of room nights in the two estimates, the Pinnacle/OPX direct spending input appears aggressive, nearly twice as high as in the revised estimate.
- Pinnacle/OPX applied one overall multiplier to all direct spending whereas the revised estimate applies industry specific multipliers provided by IMPLAN.
- The Pinnacle/OPX report does not quantify the impact to jobs and earnings whereas the revised estimate does.

For these reasons, meaningful and accurate comparisons between the two studies cannot be made. As such, the following section only includes the HGS/Crossroads estimate for a stabilized year stated in 2011 dollars.

Summary of Estimated Economic Impacts from Proposed Hotel Operations

The table below summarizes the estimated economic impacts generated from on-going proposed hotel operations in terms of direct, indirect/induced and total spending, jobs and earnings and is followed by a discussion of each component.

Summary of Economic Impacts - Stabilized Year Generated From Proposed New Downtown Frederick Hotel	
Category	**Crossroads/HGS 2011 $**
Spending	
Direct Spending	$16,506,000
Indirect/Induced Spending	9,376,000
Total Spending	$25,882,000
Total Jobs	280
Total Earnings	$9,015,000

Notes: Earnings represent the wages and salaries earned by employees of businesses associated with or impacted by the proposed hotel.

<u>Direct Spending</u>

As mentioned previously, the first step in calculating economic impact is estimating the direct spending. The benefits generated result from the impact of direct spending both by guests and activities that support events held at the proposed hotel.

Direct spending estimates include hotel operating revenues which represent guest and event spending that takes place inside the property as well as outside hotel guest spending. Outside hotel guest spending is estimated based on the distribution of room night demand by market segment presented previously and various secondary sources related to per person spending per day such as Business Travel News, Maryland Department of Tourism and the U.S. General Services Administration. Outside hotel spending includes expenditures on incidentals, entertainment and transportation related items. Direct spending estimates are presented in the following table.

Summary of Direct Spending - Stabilized Year	
Category	**2011 $**
Hotel Operating Revenues	$11,303,000
Outside Hotel Guest Spending	$5,203,000
Total Direct Spending	**$16,506,000**

These direct spending amounts were then applied to Frederick County multipliers in order to calculate estimates for total spending, total jobs and total earnings.

Indirect and Induced Impacts

The IMPLAN model is used to generate the indirect and induced impacts spawned from the estimated economic activities within the area. The indirect impacts represent inter-industry trade from business to business. Likewise, the induced impacts represent the economic activity spurred by the household trade that occurs when employees make consumer purchases with their incomes. According to the IMPLAN model, direct spending spurred by the proposed hotel's operations was estimated to generate $9.4 million in indirect/induced spending.

Total Spending

Outputs from the IMPLAN model indicate that total (i.e., direct, indirect and induced) spending from the proposed hotel's operations was estimated to be $25.9 million.

Total Jobs

Based on the IMPLAN model, which calculates the number of jobs per $1.0 million in direct spending, the economic activity associated with the proposed hotel's operations was estimated to support approximately 280 total jobs. These jobs are created in many sectors of the economy, which both directly and indirectly support the increased level of business activity in the area.

Total Earnings

Outputs from the IMPLAN model indicate that total earnings generated from the proposed hotel's operations were estimated to be $9.0 million.

Summary of Estimated Fiscal Impacts from Proposed Hotel Operations

As shown in the following table, the proposed hotel's operations were estimated to generate nearly $1.9 million in tax revenues between the C and the State. This analysis does not assume any potential tax incentives to the private hotel developer. More than 80% of estimated tax revenues occur at the State level.

Summary of Fiscal Impacts - Stabilized Year Generated From Proposed New Downtown Frederick Hotel	
Municipality/Tax	**Crossroads/HGS 2011 $**
Frederick County	
Hotel/Motel Tax	$221,000
Local Personal Income Tax	100,000
Subtotal	$321,000
State of Maryland	
Sales & Use Tax	$1,100,000
Personal Income Tax	314,000
Corporate Income Tax	78,000
Motor Vehicle Rental Tax	54,000
Subtotal	$1,546,000
GRAND TOTAL	**$1,867,000**

Sources: HGS, Crossroads.

As mentioned previously, local and State jurisdictions will benefit from additional taxes (e.g., real property tax) that are not shown in the above table.

The following outlines significant assumptions utilized in this analysis.

<u>Frederick County Taxes</u>

Hotel/Motel Tax – The County taxes short-term overnight stays at a rate of 3.0%. This rate was applied to 100% of the estimated direct hotel spending. Legislation is currently pending to increase the hotel tax rate which could generate additional revenues.

Local Personal Income Tax – Frederick County imposes a local personal income tax rate of 2.96% which is assessed against personal income earned in the County. For purposes of this analysis and based on information provided by the Comptroller of Maryland, an effective tax rate of 2.22% was calculated based on the federal adjusted gross income and the total personal income tax paid to the County in 2010 (the most recent year for which data was available). This effective tax rate was applied to total earnings estimated to be generated from the proposed hotel's operations. Because local income tax is based on where you live, not where you work, this analysis assumed that approximately 50% of personal income taxes generated by the proposed hotel's operations occur in the County.

State of Maryland Taxes

Combined, the sales and use tax, personal income tax, and corporate income tax generate approximately 86% of the State's tax proceeds from all sources. While other taxes may be positively impacted by proposed hotel operations, they are not quantified in this analysis.

In general terms, all State tax proceeds are collected in the State's General Fund and then allocated to variety of program areas, such as education, transportation, public safety, and others. As such, individual revenue sources, such as the sales and use tax, are not designated to fund specific programs. As a result of this process, municipalities and counties may benefit from a variety of State and locally administered programs. For purposes of this analysis, only collections have been quantified, without regard as to how these funds are ultimately spent through the individual State departments/funds.

The following describes the primary State-level taxes quantified in this analysis based on information obtained from the State of Maryland Comptroller.

Sales and Use Tax **–** The State of Maryland collects a sales and use tax from sales and leases of tangible personal property and services throughout the State. Sales and use tax is uniform throughout the State at 6.0%. This tax source is the State's second largest source of general fund revenue. For purposes of this analysis, the tax rate was applied to total taxable direct spending as well as a percentage of indirect/induced spending at the State level generated from proposed the hotel's operations.

Personal Income Tax **–** The State of Maryland imposes a personal income tax assessed against personal income earned in the State. The State income tax is a graduated rate ranging from 2.0% to 6.25% of taxable income. Non-residents are subject to a special nonresident tax rate of 1.25% in addition to the State income tax rate. This tax source is the State's largest single source of general fund revenue. For purposes of this analysis and based on information provided by the Comptroller of Maryland, an effective tax rate of 3.48% was calculated based on the federal adjusted gross income and the total personal income tax paid to the State in 2010 (the most recent year for which data was available). This effective tax rate was applied to total earnings estimated to be generated from the proposed hotel's operations.

Corporate Income Tax **–** A corporate income tax of 8.25% of corporate federal taxable income adjusted by State modifications is also levied by the State of Maryland on corporations. For purposes of this analysis and based on information provided by the Comptroller of Maryland, an effective tax rate of 0.3% was calculated based on the Gross State Product and the total corporate income tax paid to the State in 2010. This effective tax rate was applied to total spending estimated to be generated from the proposed hotel's operations.

Other Potential Fiscal Impacts

Real Property Tax – Real property is calculated based on a specific rate per $100 of assessed value and distributed among the City, County, State and urban fire and rescue district. Given the preliminary nature of this project, no construction cost estimates are provided as part of this analysis. However, preliminary estimates suggest that real property tax generated from the proposed new hotel could be in the range of $650,000 to $750,000 annually in a stabilized year of operations in 2011 dollars depending on the property tax rate and the assessed value.

Summary of Estimated Economic and Fiscal Impacts for Proposed Hotel

The proposed increase in hotel rooms in downtown Frederick should benefit the City, County and the State in terms of both economic and fiscal benefits. While there may be some shift of existing room nights in the area to the proposed new hotel, it is not likely to be significant given that the proposed hotel will be the only full-service hotel relative to the existing room supply.

In a stabilized year, the proposed hotel could generate approximately 52,600 room nights. This activity is estimated to generate approximately $16.5 million in direct spending in 2011 dollars. Outputs from the IMPLAN model indicate that total output, including direct, indirect and induced effects, generated from the proposed hotel's operations could be approximately $25.9 million in 2011 dollars. This spending is estimated to support approximately 280 jobs that would create $9.0 million in personal earnings. In addition, these transactions are subject to taxes that are estimated to generate $1.9 million in 2011 dollars at the local and State levels.

Overall Summary

While some of the market and economic characteristics have changed since the Pinnacle/OPX report, market demand still exists for the proposed new full-service hotel in downtown Frederick. Given updated market research, the distribution of room demand by market segment differs from the previous report which directly impacts the estimate of average room rates and resulting financial operating characteristics. However, the revised estimate of net operating income is comparable to that in the Pinnacle/OPX study. Due to methodology differences, economic impact estimates are not directly comparable between the two studies.

Next Steps

A market/economic analysis is an initial step in any planning process. Based on market research and corresponding economic/fiscal benefits that could potentially be generated by the proposed new hotel, next steps may include:

- Conduct a more detailed site comparison and select a definitive site for the proposed new hotel.
- Select a hotel developer, operator, designer, builder, and property brand.
- Refine proposed program into a more detailed spatial program and conceptual design which maximizes marketability relative to competitive set, operational functionality, physical site constraints, and minimizes cost.
- Develop construction and total project costs.
- Develop a cost-benefit analysis including the estimated return on investment for potential funding partners.
- Identify a potential financing strategy for the project which may ultimately require some level of public participation.

Appendix

The following summarizes the proposed hotel's estimated financial pro forma for the first five years of operation in inflated dollars.

Statement of Estimated Annual Operating Results (Inflated $000s) Proposed Full-Service Hotel in Downtown Frederick, Maryland										
Year #:	**1**		**2**		**3**		**4**		**5**	
Year:	**2016**		**2017**		**2018**		**2019**		**2020**	
Available Rooms	200		200		200		200		200	
Occupancy	53%		64%		69%		72%		72%	
Occupied Rooms:	38,690		46,720		50,370		52,560		52,560	
Average Rate:	$160		$165		$169		$174		$178	
REVENUES	**$**	**%**	**$**	**%**	**$**	**%**	**$**	**%**	**$**	**%**
Rooms	$6,190.4	64.9%	$7,699.5	67.0%	$8,507.5	67.6%	$9,119.2	68.0%	$9,366.2	68.0%
Food Sales	2,342.9	24.6%	$2,617.8	22.8%	$2,787.4	22.2%	$2,923.5	21.8%	$3,002.5	21.8%
Beverage Sales	567.9	6.0%	$646.8	5.6%	$693.9	5.5%	$730.9	5.5%	$750.6	5.5%
Total Food and Beverage Sales	2,910.8	30.5%	$3,264.6	28.4%	$3,481.3	27.7%	$3,654.4	27.3%	$3,753.1	27.3%
Telephone	30.3	0.3%	$37.1	0.3%	$40.9	0.3%	$43.7	0.3%	$44.9	0.3%
Rentals and Other Income	411.6	4.3%	$499.0	4.3%	$548.0	4.4%	$584.7	4.4%	$600.5	4.4%
GROSS REVENUE	**9,543.1**	**100.0%**	**$11,500.2**	**100.0%**	**$12,577.7**	**100.0%**	**$13,402.0**	**100.0%**	**$13,764.7**	**100.0%**
DEPARTMENTAL EXPENSES										
Rooms	1,472.6	23.8%	$1,615.7	21.0%	$1,707.6	20.1%	$1,783.4	19.6%	$1,831.5	19.6%
Food and Beverage	2,050.2	70.4%	2,290.9	70.2%	2,439.3	70.1%	2,558.4	70.0%	2,627.5	70.0%
Telephone	32.5	107.3%	39.3	105.9%	43.2	105.6%	46.1	105.5%	47.3	105.3%
Minor Operated Departments										
TOTAL DEPARTMENTAL EXPENSES	**3,555.3**	**37.3%**	**$3,945.9**	**34.3%**	**$4,190.1**	**33.3%**	**$4,387.9**	**32.7%**	**$4,506.3**	**32.7%**
DEPARTMENTAL PROFIT	**5,987.8**	**62.7%**	**$7,554.3**	**65.7%**	**$8,387.6**	**66.7%**	**$9,014.1**	**67.3%**	**$9,258.4**	**67.3%**
UNDISTRIBUTED EXPENSES										
Administrative and General	747.8	7.8%	833.0	7.2%	868.0	6.9%	899.1	6.7%	923.4	6.7%
Management Fee	286.3	3.0%	345.0	3.0%	377.3	3.0%	402.1	3.0%	412.9	3.0%
Marketing	887.7	9.3%	933.5	8.1%	968.9	7.7%	1,001.3	7.5%	1,028.4	7.5%
Energy	622.8	6.5%	660.3	5.7%	687.7	5.5%	712.2	5.3%	731.4	5.3%
Repairs and Maintenance	660.1	6.9%	688.6	6.0%	712.2	5.7%	734.4	5.5%	754.3	5.5%
TOTAL UNDISTRIBUTED EXPENSES	**3,204.7**	**33.6%**	**3,460.4**	**30.1%**	**3,614.1**	**28.7%**	**3,749.1**	**28.0%**	**3,850.4**	**28.0%**
GROSS OPERATING PROFIT	**2,783.1**	**29.2%**	**4,093.9**	**35.6%**	**4,773.5**	**38.0%**	**5,265.0**	**39.3%**	**5,408.0**	**39.3%**
FIXED CHARGES										
Property Taxes	792.8	8.3%	836.2	7.3%	858.8	6.8%	882.0	6.6%	905.8	6.6%
Insurance	97.6	1.0%	100.2	0.9%	102.9	0.8%	105.7	0.8%	108.5	0.8%
TOTAL FIXED CHARGES	**890.4**	**9.3%**	**936.4**	**8.1%**	**961.7**	**7.6%**	**987.7**	**7.4%**	**1,014.3**	**7.4%**
NET INCOME BEFORE RESERVES	**1,892.7**	**19.8%**	**3,157.5**	**27.5%**	**3,811.8**	**30.3%**	**4,277.3**	**31.9%**	**4,393.7**	**31.9%**
Reserve for Replacement	190.9	2.0%	345.0	3.0%	503.1	4.0%	536.1	4.0%	550.6	4.0%
NET INCOME AFTER RESERVES	**$1,701.8**	**17.8%**	**$2,812.5**	**24.5%**	**$3,308.7**	**26.3%**	**$3,741.2**	**27.9%**	**$3,843.1**	**27.9%**

Source: HGS