

Hotel Market Research

Morgan Hill, California

PREPARED FOR: CITY OF MORGAN HILL

PREPARED BY: HA&A

7/9/2015

Executive Summary

Executive Summary

- How can existing hotels in Morgan Hill be classified?

Hotels are typically categorized by hotel brand affiliation and chain scale. In Morgan Hill, Marriott, Hilton, IHG, Choice, Wyndham, and Extended Stay America brands are represented, but not Hyatt and Starwood. In terms of chain scales, two hotels are categorized as upscale, three hotels are upper-midscale, and others belong to lower chain scales. Chain scales are defined and published by STR each year, based on system-wide average rates for each brand operating in the United States.

- How many more hotels can the Morgan Hill market support?

Developers typically begin to target a market for new hotel construction when top-performing existing hotels demonstrate occupancies in excess of 70% for multiple years, on an annual basis. Moreover, upscale hotel development is typically targeted when RevPAR levels can be expected to exceed approximately \$90 on an annual basis. Instead of trying to determine how many more hotels a market can support, hotel investors and developers typically ask a different question. They ask: Can we develop a new hotel that will compete favorably in this market? We expect to see continued interest in development so long as: (1) existing hotels demonstrate sustained strong performance levels; (2) popular national brands remain available; and (3) capital markets continue to provide debt and equity for hotel construction.



Executive Summary

- What is the impact from new supply on Transient Occupancy Tax (TOT)?

Supply growth generally has a positive impact on TOT, as additional inventory increases total room nights available to be accommodated in the market. Newer, higher-quality hotels can also increase the market's average rate, which typically leads to higher TOT revenues in markets that can support higher-rated hotels. In 2014, newer, upscale and upper midscale hotels in Morgan Hill made up 79% of total TOT.

Market Analysis

S.W.O.T Summary

Strengths

- Expanding Economic Base
- Silicon Valley Location
- Proximity from/to San Jose
- Leisure attractions
- Major events (Taste of Morgan Hill, Freedom Fest, and Mushroom Mardi Gras)
- Sporting Recreation (Outdoor Sports Center and Aquatics Center)

Weaknesses

- Dependence on San Jose and Silicon Valley businesses
- Leisure demand appears to be highly seasonal with relatively weak weekend occupancies between November and February
- Cost of installing infrastructure
- Residential Control Growth Ordinance

Opportunities

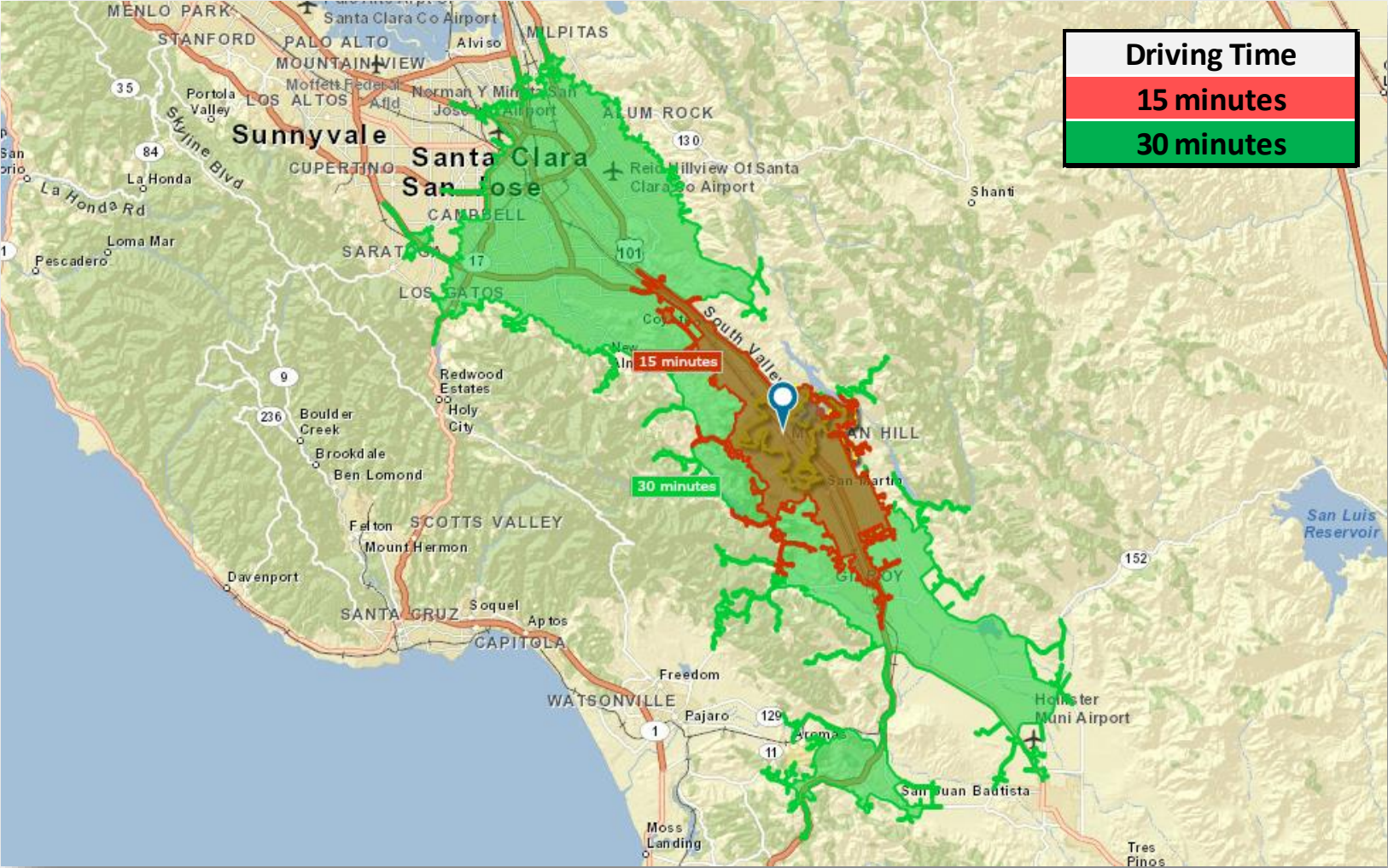
- Strong Occupancy and ADR Trend
- Substantial Unaccommodated Demand
- Missing Major Hotel Brands
- Potential to Grow Additional Demand Generators

Threats

- San Jose Supply Growth
- Economic Cycles

Conveniently located along U.S. Route 101...

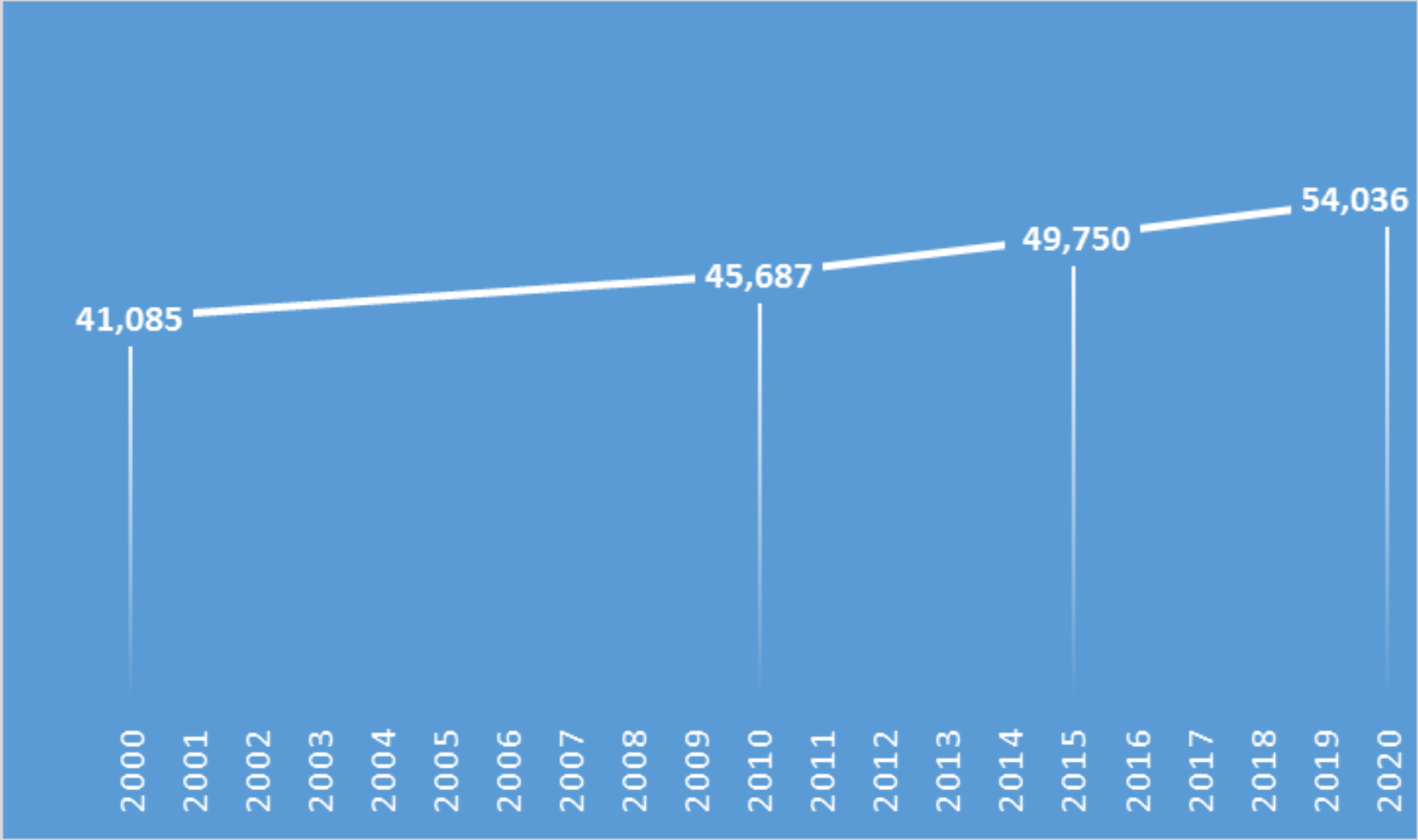
... highly accessible from San Jose



Source: ESRI



Population is projected to continue to increase in Morgan Hill

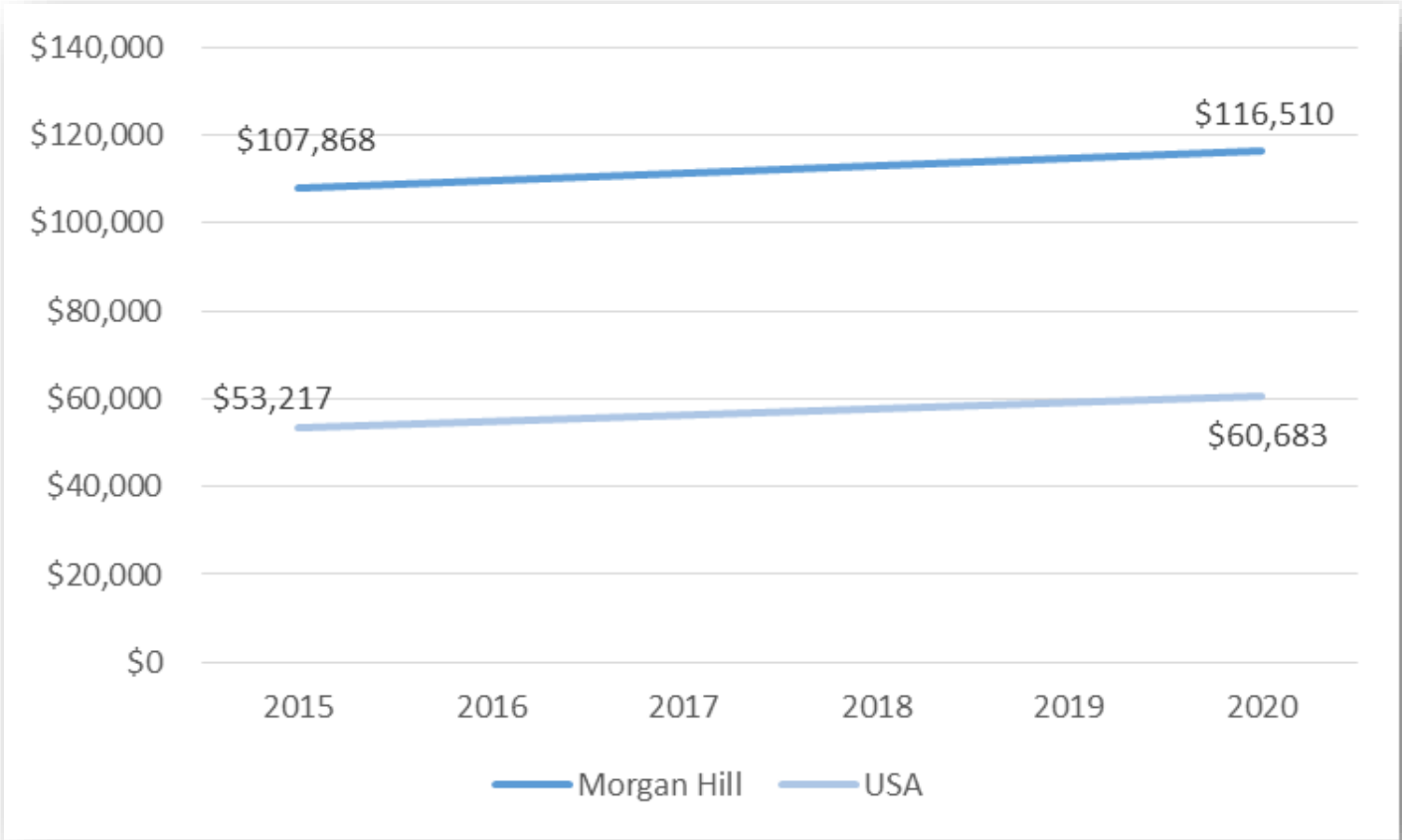


Source: ESRI



Median household incomes...

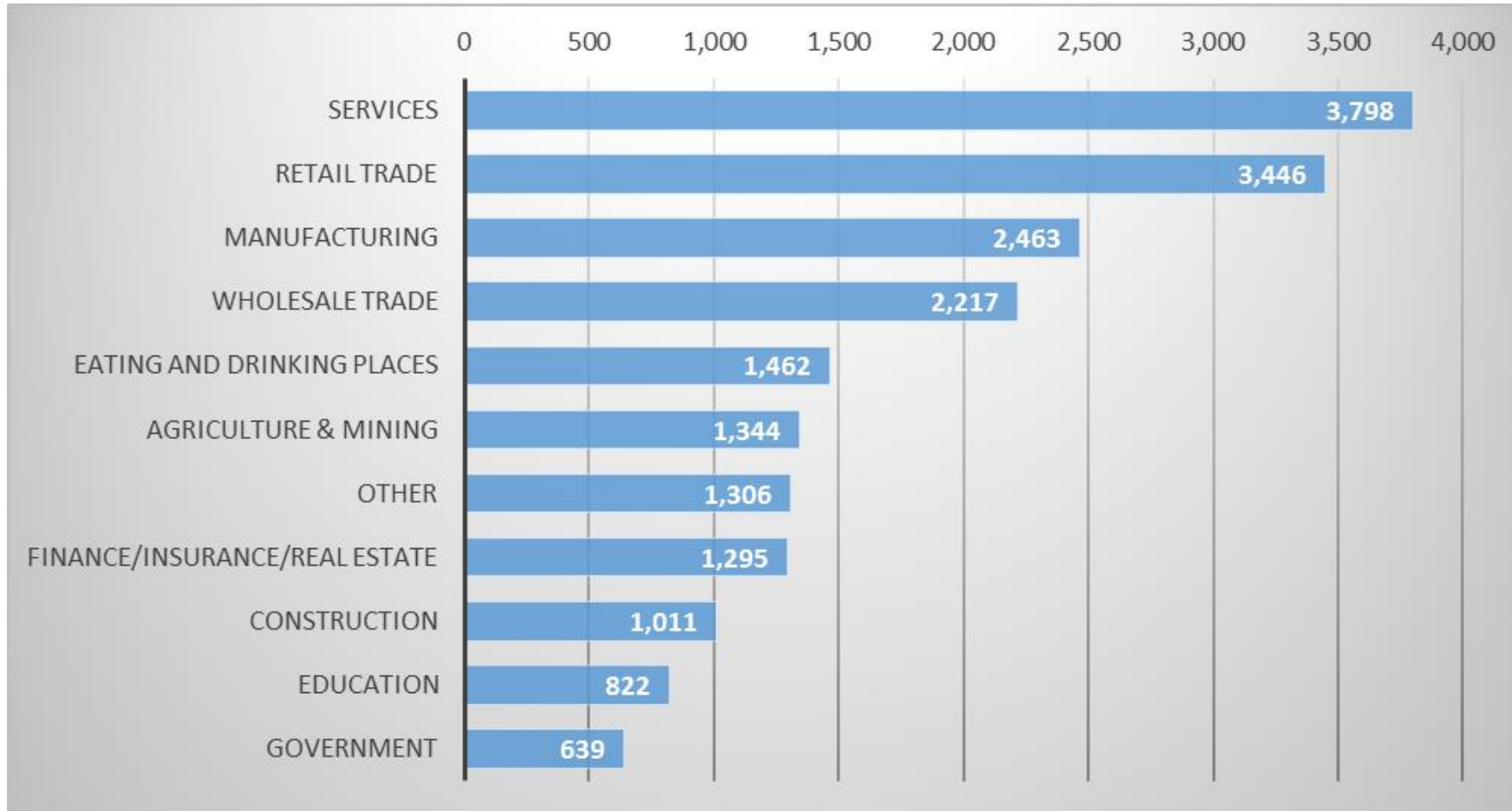
...much higher than the national average



Source: ESRI



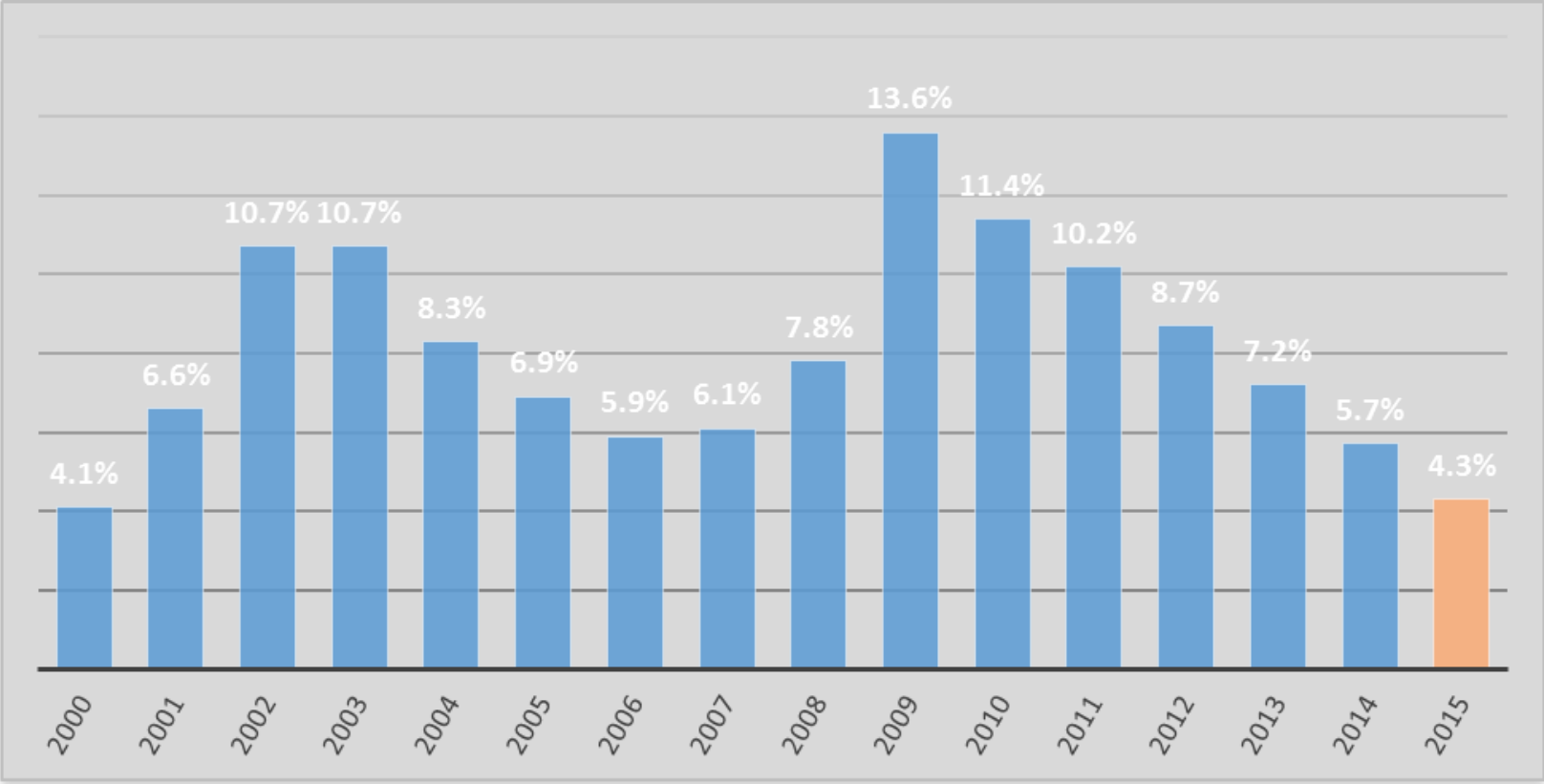
Somewhat Diverse Employment Base



Source: ESRI



Unemployment rate in Morgan Hill... ...near lowest level since Dot-com bubble



Source: Bureau of Labor Statistics



Market Analysis – Demand Generators

Commercial

- Anritsu
- Specialized Bicycles
- Anaerobe Systems
- Infineon Technologies
- Sakata Seeds
- ITT Corporation
- Paramit
- TenCate Advanced Composites
- Flextronics International
- San Jose Business

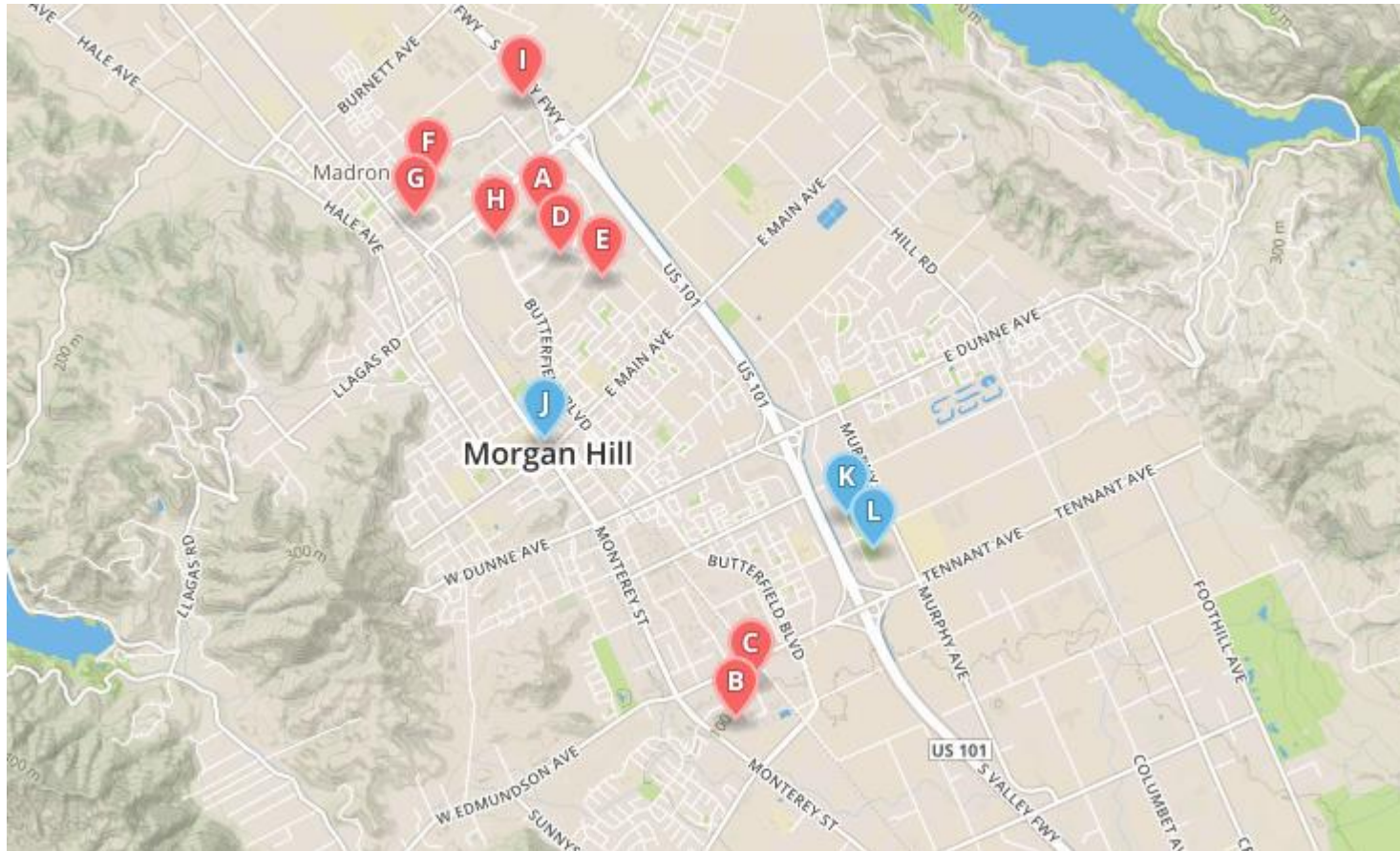
Leisure

- Amateur Sports
- Friends and Relatives
- 22 Wineries
- 7 Golf Courses
- Outdoor Activities
 - Lakes
 - Parks
 - Ranches
- Seasonal Festivals and Events
 - Downtown Wine Stroll
 - Mushroom Mardi Gras
 - Freedom Fest
 - Taste of Morgan Hill
 - Morgan Hill Marathon

Group

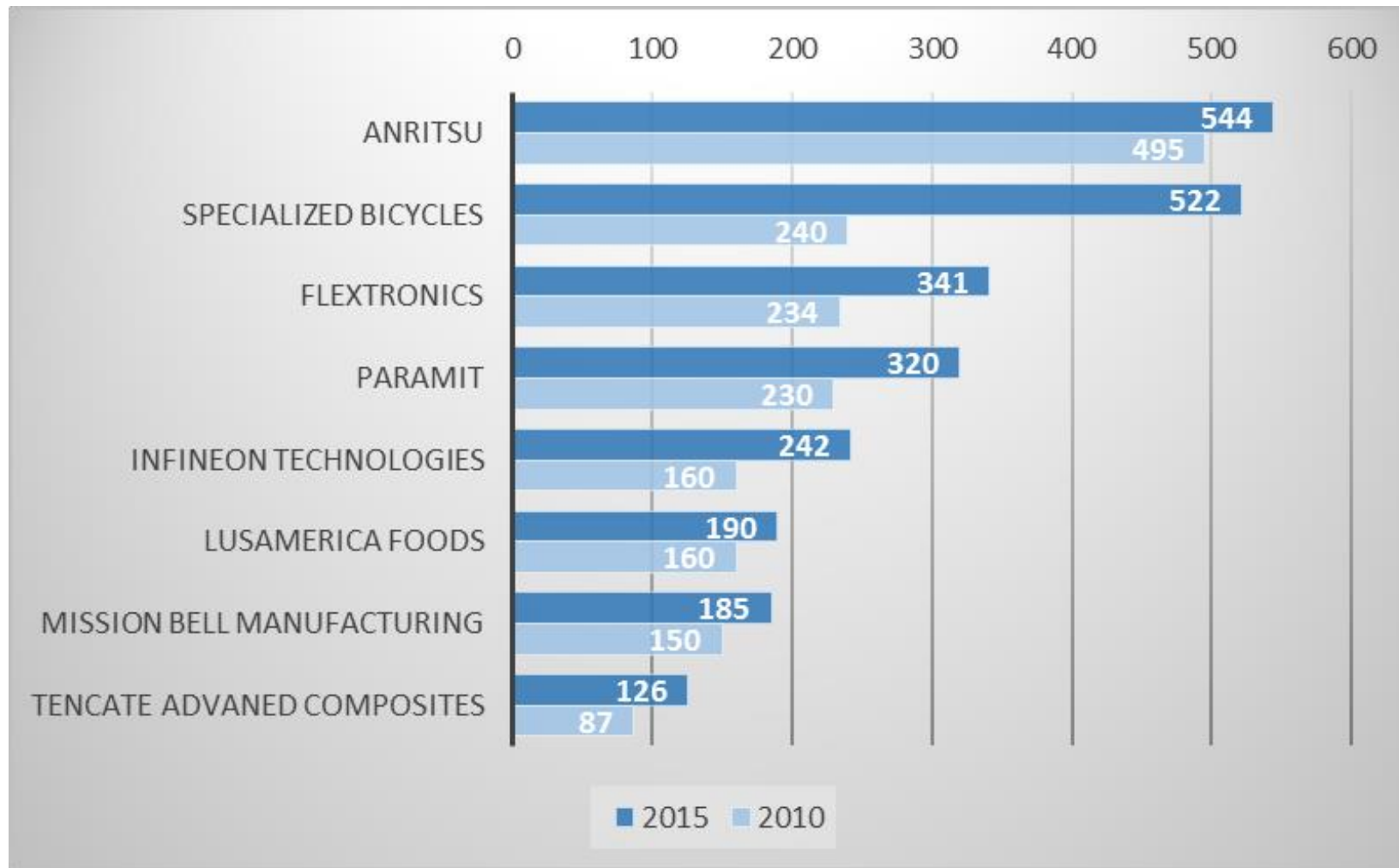
- Morgan Hill Aquatics Center
- Morgan Hill Outdoor Sports Center
- McEnery Convention Center (San Jose)
- Social
- Military
- Education
- Religious
- Fraternal

Demand Generators Map



A	Anritsu
B	Specialized Bicycles
C	Anaerobe Systems
D	Infineon Technologies
E	Sakata Seeds
F	ITT Corporation
G	Paramit
H	TenCate Advanced Composites
I	Flextronics International
J	Morgan Hill Downtown
K	Morgan Hill Aquatic Center
L	Morgan Hill Outdoor Sports Center

Top Employers Have Been Adding Jobs



Source: City of Morgan Hill



Leisure Attractions Map



Source: City of Morgan Hill



Morgan Hill 2015 – 2016 Events

Month	Events	Number of Attendees
July	Freedom Fest	64,500
September	British Falls Classic Car Show	500
September	Taste of Morgan Hill	20,000
October	Makos Meet	1,800
November	Morgan Hill Marathon	2,500
December	Makos Swim Meet	1,200
February	Quicksilver/Morgan Hill Splash	500
March	AAUW Wildflower Run	900
April	Far Westerns Meet	1,547
May	Specialized Spring Classic	1,000
May	Mushroom Mardi Gras	35,000
Total		129,447

Source: City of Morgan Hill Community Services Department

* The list only includes events which are expected to generate lodging demand by Community Services Department

Outdoor Sports Center Events

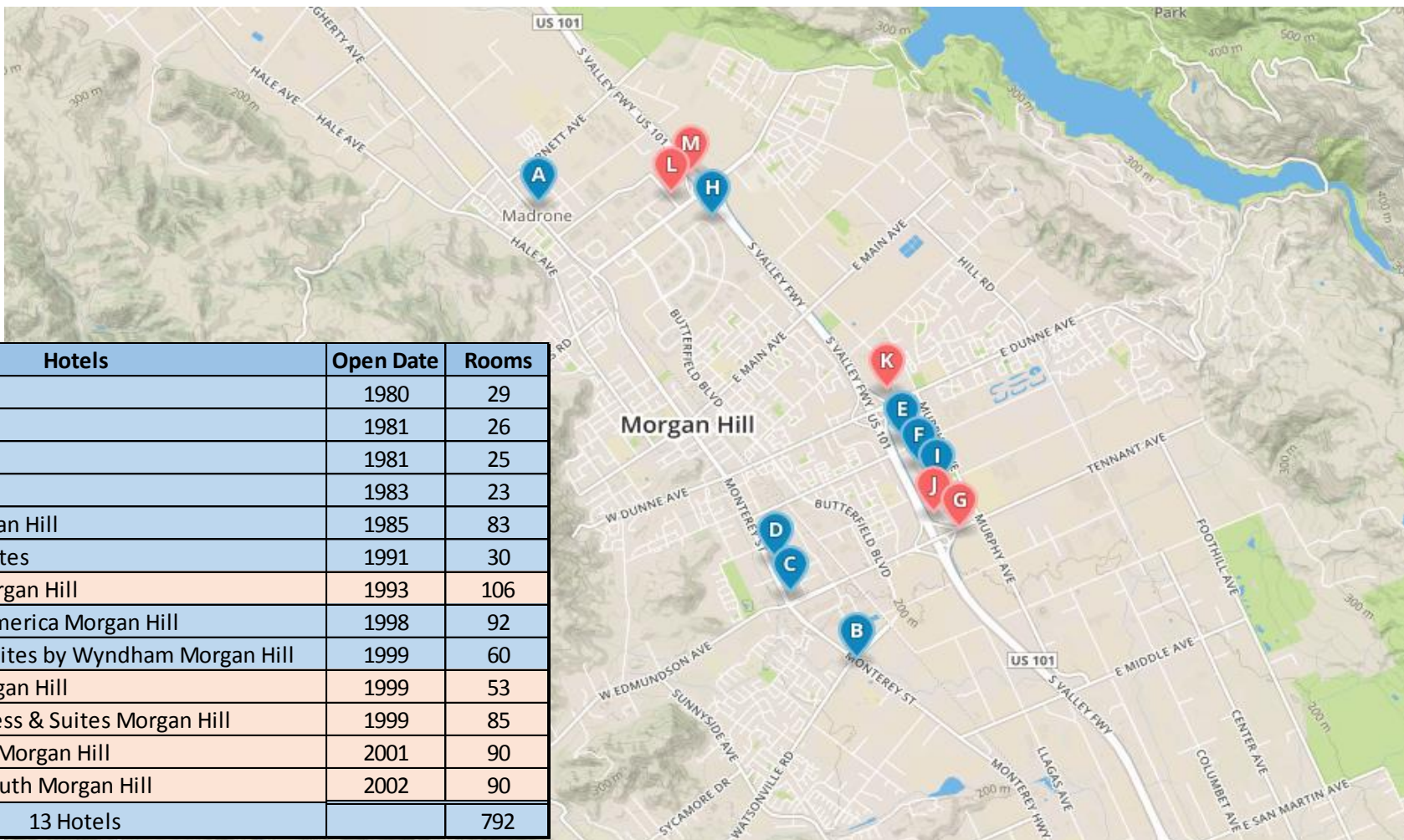
Year	Event Type	Number of Attendees
2015	Tournaments (28)	229,200 visitors
2015	Events (2)	30,000 attendees
2015	Camps (4)	1,000 players
Total		260,200

Source: City of Morgan Hill Community Services Department



Hotel Supply and Demand Analysis

There are 13 Hotels in Morgan Hill



* We have excluded the Paradise Motel, the Rancho Motel, and the Maple Leaf RV Park because these are not primarily considered as lodging facilities



High rated hotels entered the market...

...Older, economy hotels nearing end of economic life

	Hotels	Affiliation	Chain Scale	Affiliation Date	Open Date	Rooms
A	Budget Inn	Independent	Economy Class	-	1980	29
B	Economy Inn	Independent	Economy Class	-	1981	26
C	Holiday Motel	Independent	Economy Class	-	1981	25
D	Morgan Hill Inn	Independent	Economy Class	1996	1983	23
E	Quality Inn Morgan Hill	Choice Hotels	Midscale Class	2006	1985	83
F	Executive Inn Suites	Independent	Economy Class	1991	1991	30
G	Hampton Inn Morgan Hill	Hilton	Upper Midscale Class	2012	1993	106
H	Extended Stay America Morgan Hill	Extended Stay America	Economy Class	1998	1998	92
I	Microtel Inn & Suites by Wyndham Morgan Hill	Wyndham	Economy Class	1999	1999	60
J	Comfort Inn Morgan Hill	Choice Hotels	Upper Midscale Class	1999	1999	53
K	Holiday Inn Express & Suites Morgan Hill	IHG	Upper Midscale Class	1999	1999	85
L	Courtyard South Morgan Hill	Marriott	Upscale Class	2001	2001	90
M	Residence Inn South Morgan Hill	Marriott	Upscale Class	2002	2002	90
	13 Hotels					792

Source: STR, HA&A

* We have excluded the Paradise Motel, the Rancho Motel, and the Maple Leaf RV Park because these are not primarily considered as lodging facilities



Strong Occupancy and ADR Recovery in Morgan Hill

Year	Room Supply	Room Night Supply	% Change	Room Night Demand	% Change	Occupancy	Average Rate	% Change	RevPAR	% Change
2000	606	221,190	--	169,323	--	76.6%	83.69	--	64.06	--
2001	629	229,470	3.7%	137,275	-18.9%	59.8%	88.08	5.2%	52.69	-17.8%
2002	786	286,890	25.0%	132,947	-3.2%	46.3%	78.26	-11.1%	36.27	-31.2%
2003	786	286,890	0.0%	134,011	0.8%	46.7%	75.05	-4.1%	35.06	-3.3%
2004	786	286,890	0.0%	151,043	12.7%	52.6%	71.31	-5.0%	37.55	7.1%
2005	786	286,890	0.0%	165,566	9.6%	57.7%	75.93	6.5%	43.82	16.7%
2006	786	286,890	0.0%	161,429	-2.5%	56.3%	78.35	3.2%	44.09	0.6%
2007	786	286,890	0.0%	176,136	9.1%	61.4%	81.79	4.4%	50.21	13.9%
2008	786	286,890	0.0%	161,184	-8.5%	56.2%	85.64	4.7%	48.12	-4.2%
2009	786	286,890	0.0%	148,412	-7.9%	51.7%	76.17	-11.1%	39.40	-18.1%
2010	786	286,890	0.0%	160,094	7.9%	55.8%	74.98	-1.6%	41.84	6.2%
2011	786	286,890	0.0%	174,602	9.1%	60.9%	77.85	3.8%	47.38	13.2%
2012	787	287,351	0.2%	178,479	2.2%	62.1%	86.80	11.5%	53.92	13.8%
2013	793	289,445	0.7%	197,210	10.5%	68.1%	99.57	14.7%	67.84	25.8%
2014	792	289,200	-0.1%	198,675	0.7%	68.7%	110.51	11.0%	75.92	11.9%
YTD 2014 thru April	793	95,160	--	58,879	--	61.9%	102.54	--	63.45	--
YTD 2015 thru April	792	95,040	-0.1%	66,383	12.7%	69.8%	120.00	17.0%	83.82	32.1%
Historical Annual Growth Rates			1.9%		1.1%			2.0%		1.2%

Sources: STR and HA&A



Local Demand Generally Increasing



- A. Dot-com Bubble Bust and 9.11
- B. Pre-Recession Peak (61.4% @ \$81.79)
- C. National Recession
- D. Expansion Period (68.7% @ \$110.51)

Source: STR, HA&A



The 5 Highest-Rated Hotels in Morgan Hill...

...Experiencing Strong Growth

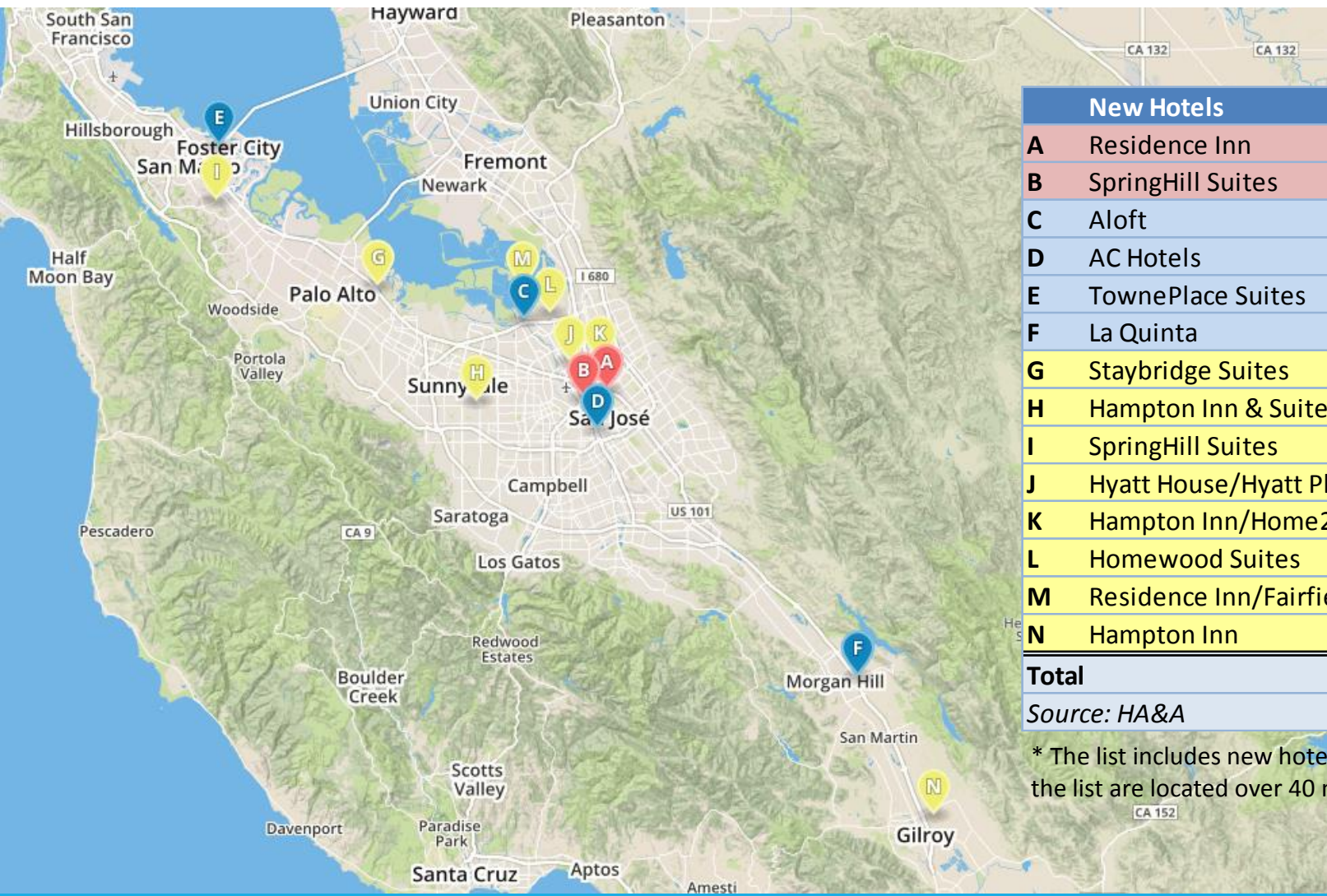
Year	Room Supply	Room Night Supply	% Change	Room Night Demand	% Change	Occupancy	Average Rate	% Change	RevPAR	% Change
2009	418	152,570	--	81,062	--	53.1%	94.82	--	50.38	--
2010	418	152,570	0.0%	89,325	10.2%	58.5%	91.34	-3.7%	53.48	6.2%
2011	418	152,570	0.0%	98,869	10.7%	64.8%	94.87	3.9%	61.48	15.0%
2012	419	153,031	0.3%	99,117	0.3%	64.8%	105.39	11.1%	68.26	11.0%
2013	425	155,125	1.4%	108,614	9.6%	70.0%	123.02	16.7%	86.13	26.2%
2014	424	154,880	-0.2%	111,660	2.8%	72.1%	133.74	8.7%	96.42	11.9%
YTD 2014 thru April	425	51,000	--	34,395	--	67.4%	125.42	--	84.59	--
YTD 2015 thru April	424	50,880	-0.2%	37,354	8.6%	73.4%	146.05	16.5%	107.23	26.8%
Historical Annual Growth Rates			0.3%		6.6%			7.1%		13.9%

Sources: STR and HA&A



Significant Supply Growth Regionally...

...2,400 Rooms in Pipeline



New Hotels	Location	Rooms	Status	
A	Residence Inn	San Jose, CA	175	Opened in June
B	SpringHill Suites	San Jose, CA	146	Opened in June
C	Aloft	San Jose, CA	175	Under Construction
D	AC Hotels	San Jose, CA	210	Under Construction
E	TownePlace Suites	Foster City, CA	121	Under Construction
F	La Quinta	Morgan Hill, CA	104	Under Construction
G	Staybridge Suites	Palo Alto, CA	147	Application Pending
H	Hampton Inn & Suites	Sunnyvale, CA	166	Application Pending
I	SpringHill Suites	Belmont, CA	69	Application Pending
J	Hyatt House/Hyatt Place	San Jose, CA	355	Application Pending
K	Hampton Inn/Home2 Suites	San Jose, CA	285	Application Pending
L	Homewood Suites	San Jose, CA	145	Application Pending
M	Residence Inn/Fairfield Inn	San Jose, CA	261	Application Pending
N	Hampton Inn	Gilroy, CA	104	Application Pending
Total			2,463	

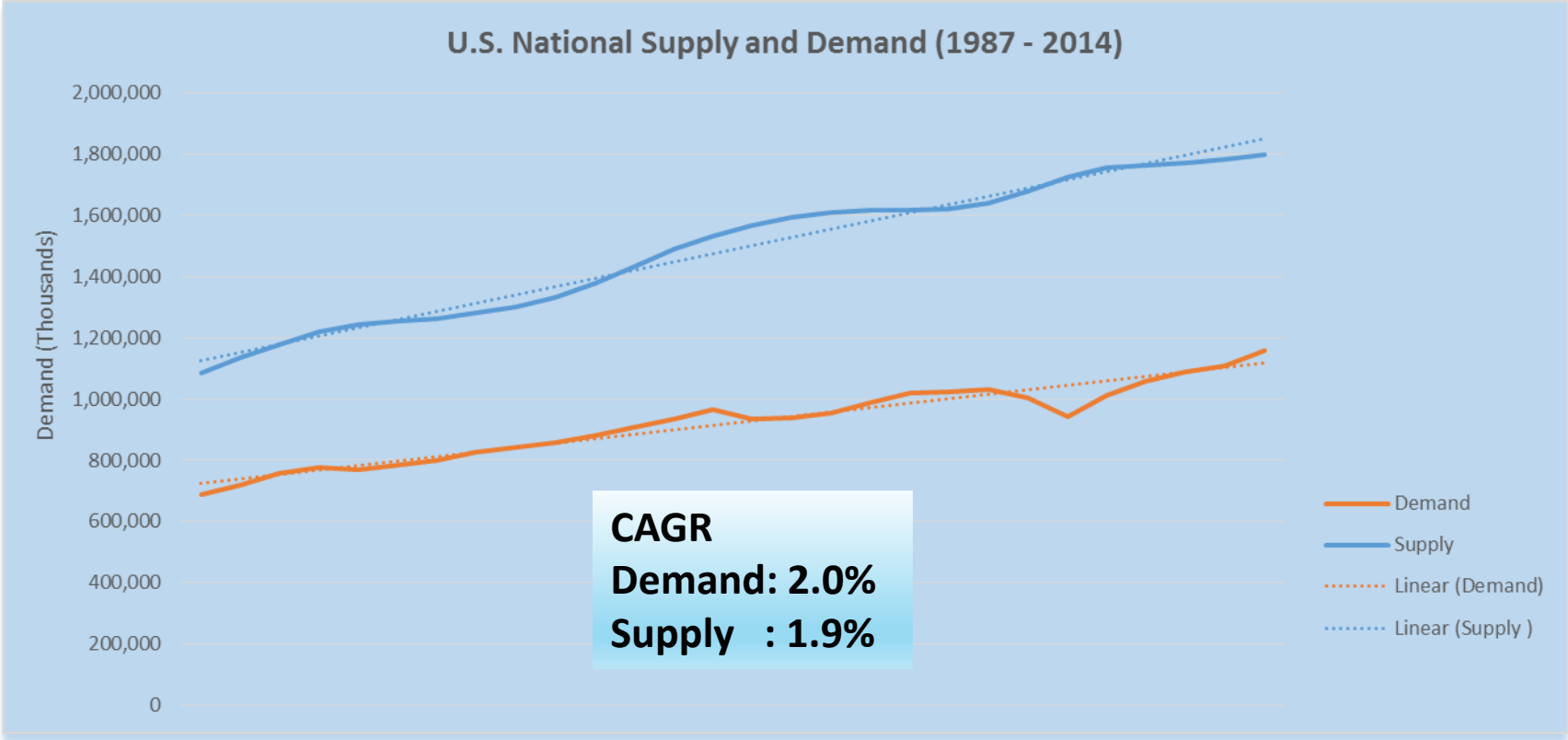
Source: HA&A

* The list includes new hotels in the San Jose market. Some hotels in the list are located over 40 miles from Morgan Hill.



Long-term National Supply and Demand...

...Appear Closely Correlated

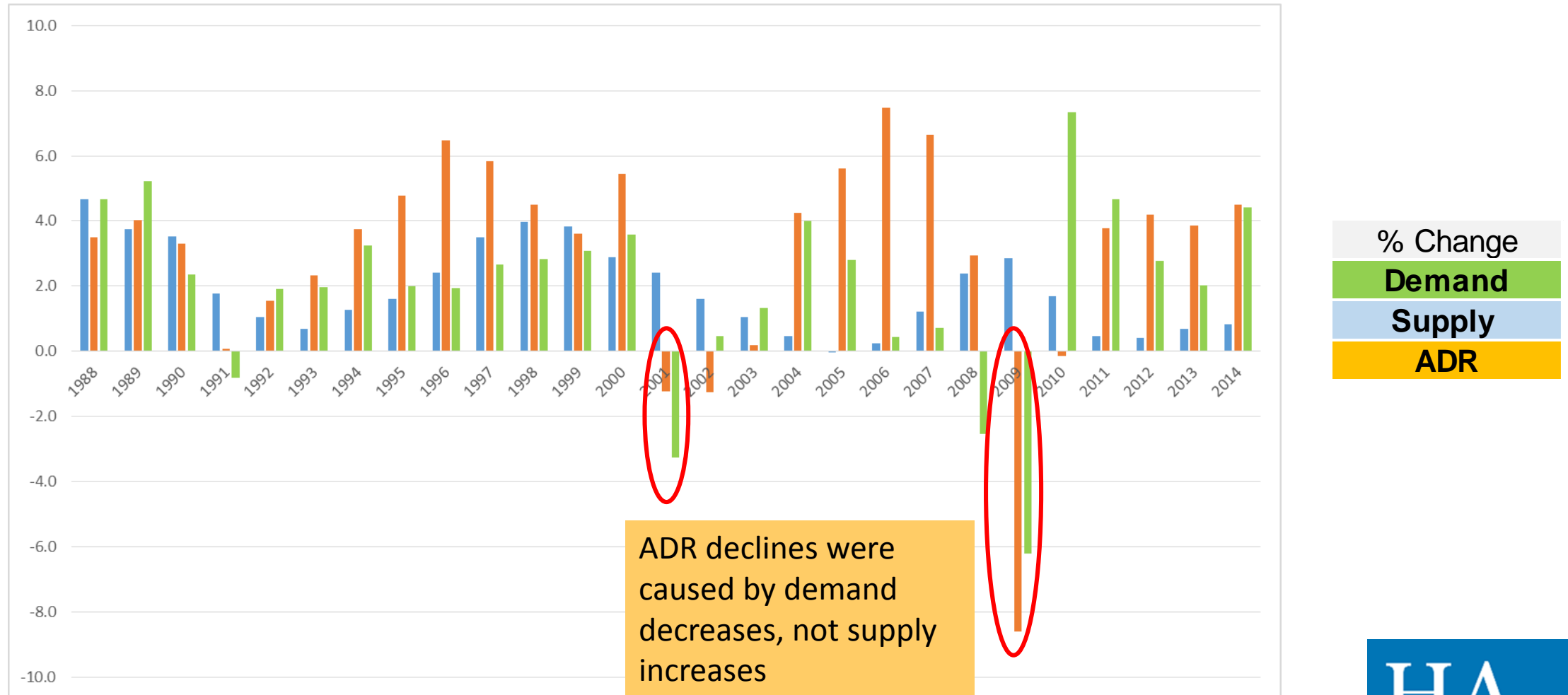


Source: STR, HA&A



There are two periods when national ADR declined since 1988...

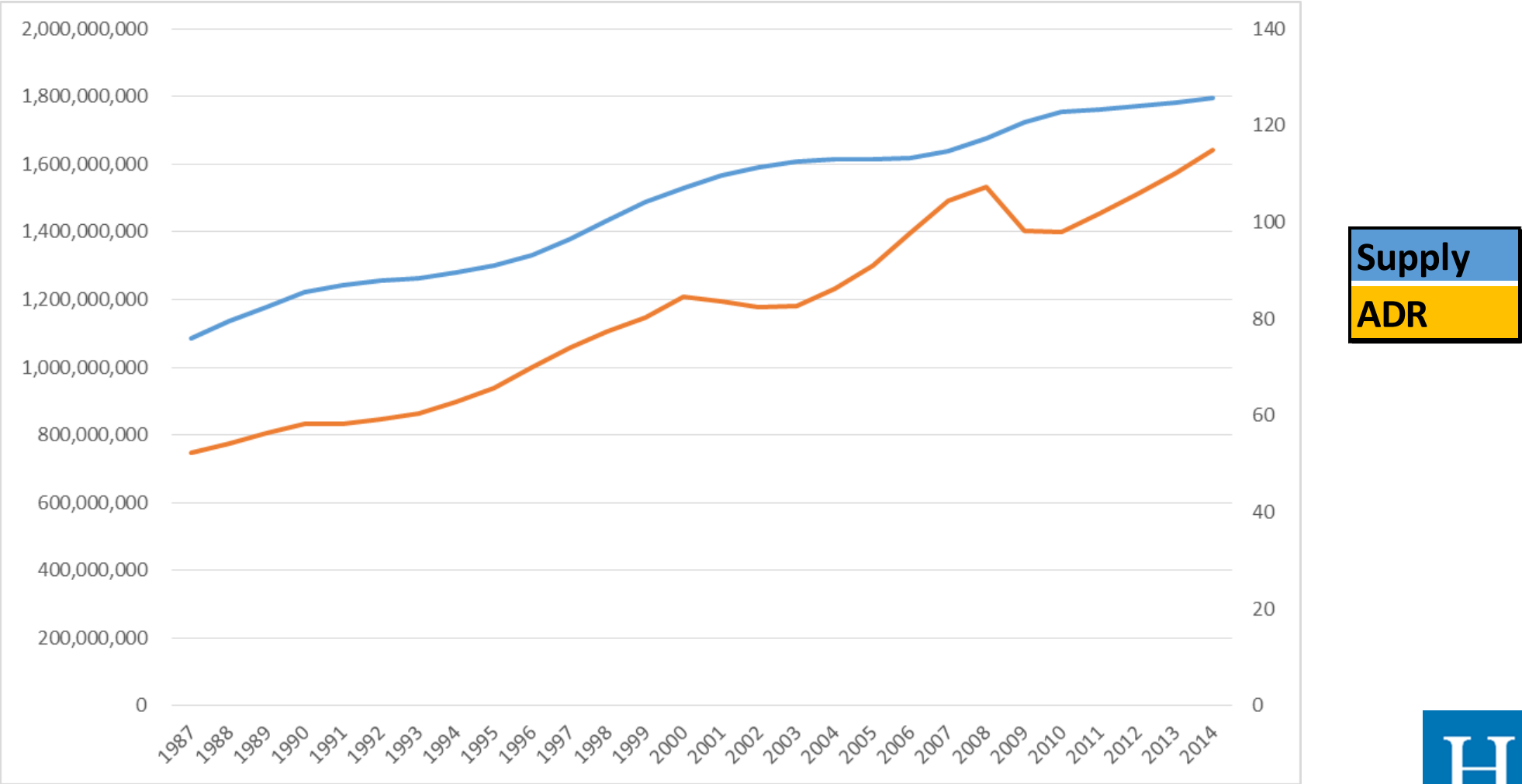
...ADR declines were caused by demand decreases, not supply increases



Source: STR, HA&A



Long-term national trend shows increases both in supply and ADR



Source: STR, HA&A



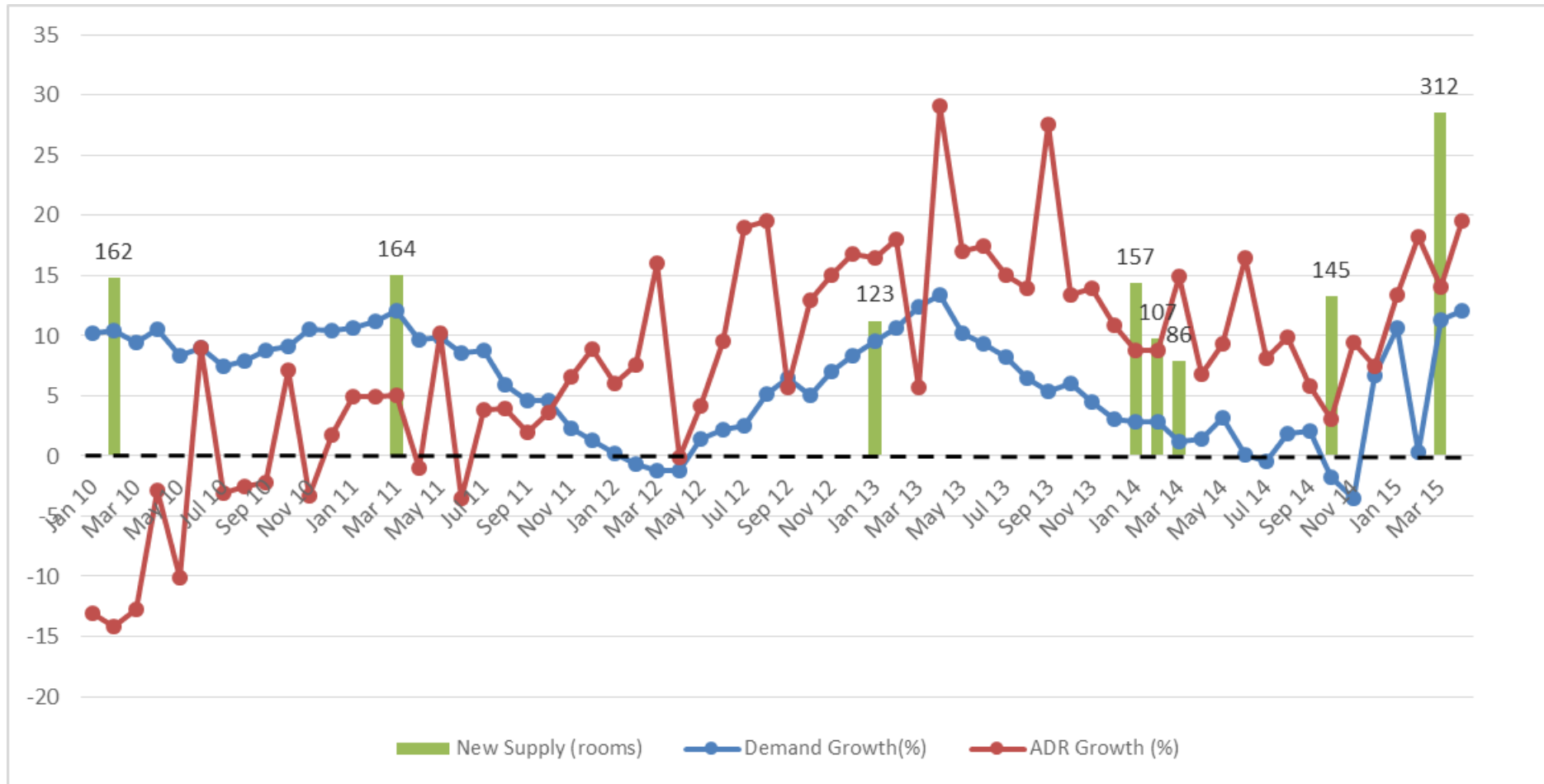
Nearly 1,400 rooms added to San Jose market since 2010

New Hotels	Location	Opening Date	Rooms
Courtyard by Marriott	Campbell, CA	Feb-10	162
Hyatt House	San Jose, CA	Mar-11	164
aloft Hotel Cupertino	Cupertino, CA	Jan-13	123
Courtyard by Marriott	San Jose, CA	Jan-14	157
TownePlace Suites by Marriott	Santa Clara, CA	Feb-14	107
Joie De Vivre The Epiphany	Palo Alto, CA	Mar-14	86
Courtyard by Marriott	Sunnyvale, CA	Oct-14	145
Homewood Suites by Hilton	Palo Alto, CA	Mar-15	138
Hilton Garden Inn	Palo Alto, CA	Mar-15	174
Residence Inn by Marriott	Menlo Park, CA	May-15	138
			1,394
<i>Source: STR, HA&A</i>			

* The list includes new hotels in the STR participation list of the San Jose market. Some hotels in the list are located over 40 miles from Morgan Hill.



...Yet Morgan Hill still has strong Demand and ADR growth



Source: STR, HA&A



Strong occupancy patterns...

...indicate substantial unaccommodated demand

Morgan Hill Top 5

	Sun	Mon	Tue	Wed	Thu	Fri	Sat
May - 14	53.2	65.9	85.8	86.6	64.9	64.3	86.7
Jun - 14	52.2	78.5	97.4	95.0	81.1	79.1	89.6
Jul - 14	56.4	82.8	88.9	87.7	75.1	87.1	86.3
Aug - 14	63.2	82.7	94.9	94.6	82.9	82.8	97.5
Sep - 14	52.2	72.1	87.4	86.3	68.9	65.8	82.6
Oct - 14	54.8	79.1	93.6	89.2	71.0	58.7	80.2
Nov - 14	41.4	73.2	84.7	84.6	68.8	52.9	67.2
Dec - 14	42.7	59.0	66.2	67.4	65.6	54.5	61.7
Jan - 15	47.0	77.0	89.6	91.3	65.3	47.5	59.8
Feb - 15	52.5	77.8	93.6	95.0	74.5	56.8	63.2
Mar - 15	47.3	78.0	91.3	89.9	70.6	62.7	84.6
Apr - 15	51.0	81.7	92.3	93.2	79.7	71.3	77.7

National

	Sun	Mon	Tue	Wed	Thu	Fri	Sat
May - 14	54.6	59.7	67.9	69.2	65.5	72.2	76.5
Jun - 14	55.4	68.3	75.3	75.8	72.5	78.0	81.1
Jul - 14	58.5	71.6	73.9	73.9	73.3	81.3	82.6
Aug - 14	58.7	69.5	73.9	73.5	68.9	75.9	81.1
Sep - 14	51.6	60.6	67.6	69.3	65.7	70.8	75.3
Oct - 14	53.3	65.1	70.3	69.8	65.6	71.9	79.3
Nov - 14	44.3	56.8	60.5	62.1	60.9	64.5	64.6
Dec - 14	43.0	51.1	52.7	55.4	50.9	55.6	58.9
Jan - 15	42.3	53.9	59.5	60.3	53.6	54.7	55.8
Feb - 15	48.0	58.2	64.4	65.7	61.2	66.7	71.5
Mar - 15	51.2	64.0	69.2	70.6	67.5	73.5	75.8
Apr - 15	49.4	64.0	69.9	69.7	66.7	73.6	74.0

Occupancy
Over 90%
Over 80%
Over 70%



Pent-up demand is for higher-rated hotels in Morgan Hill

Morgan Hill Top 5 (72%@\$134)

	Sun	Mon	Tue	Wed	Thu	Fri	Sat
May - 14	53.2	65.9	85.8	86.6	64.9	64.3	86.7
Jun - 14	52.2	78.5	97.4	95.0	81.1	79.1	89.6
Jul - 14	56.4	82.8	88.9	87.7	75.1	87.1	86.3
Aug - 14	63.2	82.7	94.9	94.6	82.9	82.8	97.5
Sep - 14	52.2	72.1	87.4	86.3	68.9	65.8	82.6
Oct - 14	54.8	79.1	93.6	89.2	71.0	58.7	80.2
Nov - 14	41.4	73.2	84.7	84.6	68.8	52.9	67.2
Dec - 14	42.7	59.0	66.2	67.4	65.6	54.5	61.7
Jan - 15	47.0	77.0	89.6	91.3	65.3	47.5	59.8
Feb - 15	52.5	77.8	93.6	95.0	74.5	56.8	63.2
Mar - 15	47.3	78.0	91.3	89.9	70.6	62.7	84.6
Apr - 15	51.0	81.7	92.3	93.2	79.7	71.3	77.7

Morgan Hill Others (65%@\$81)

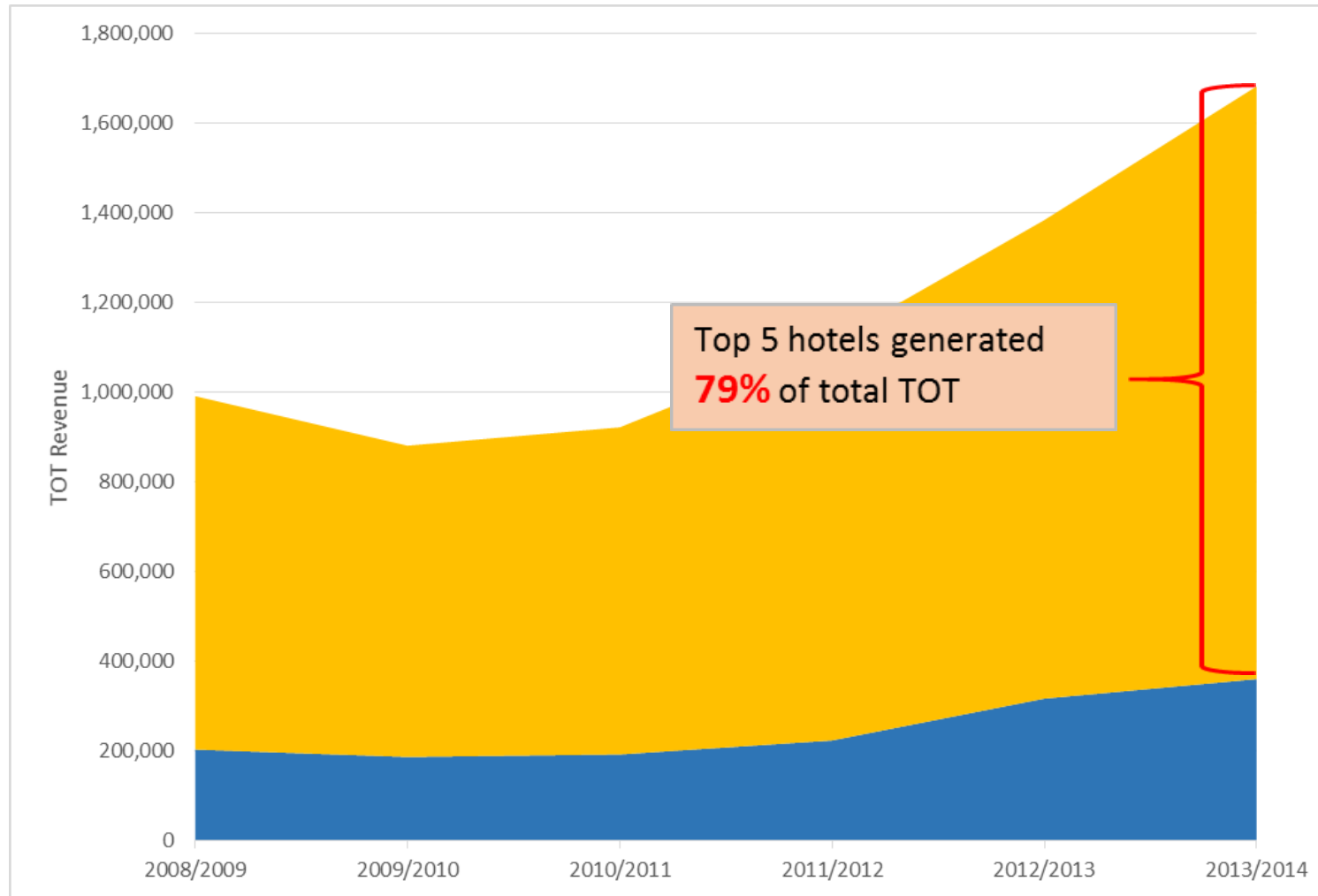
	Sun	Mon	Tue	Wed	Thu	Fri	Sat
May - 14	57.9	60.2	74.5	74.7	65.8	64.8	77.9
Jun - 14	54.5	70.0	87.2	83.2	79.8	79.2	88.4
Jul - 14	57.9	76.4	79.4	78.8	75.4	84.5	85.9
Aug - 14	62.1	70.7	79.6	78.7	75.1	79.4	89.2
Sep - 14	54.6	66.0	77.1	73.7	65.0	68.6	77.5
Oct - 14	56.3	68.0	78.0	75.9	68.9	65.8	75.7
Nov - 14	47.6	68.3	77.5	73.0	64.0	56.9	65.3
Dec - 14	42.4	54.3	58.0	56.6	55.5	53.3	54.9
Jan - 15	45.7	66.8	78.8	77.0	63.5	52.9	54.8
Feb - 15	47.8	64.0	75.3	75.1	63.3	49.1	57.4
Mar - 15	50.2	67.5	76.8	73.4	63.4	57.6	78.3
Apr - 15	51.8	69.8	81.6	82.5	73.9	68.0	75.3

Occupancy
Over 90%
Over 80%
Over 70%



79% TOT Revenue is from Five Newer Upscale and Upper Midscale Hotels...

... Combination of Higher Occupancy and Average Daily Rate



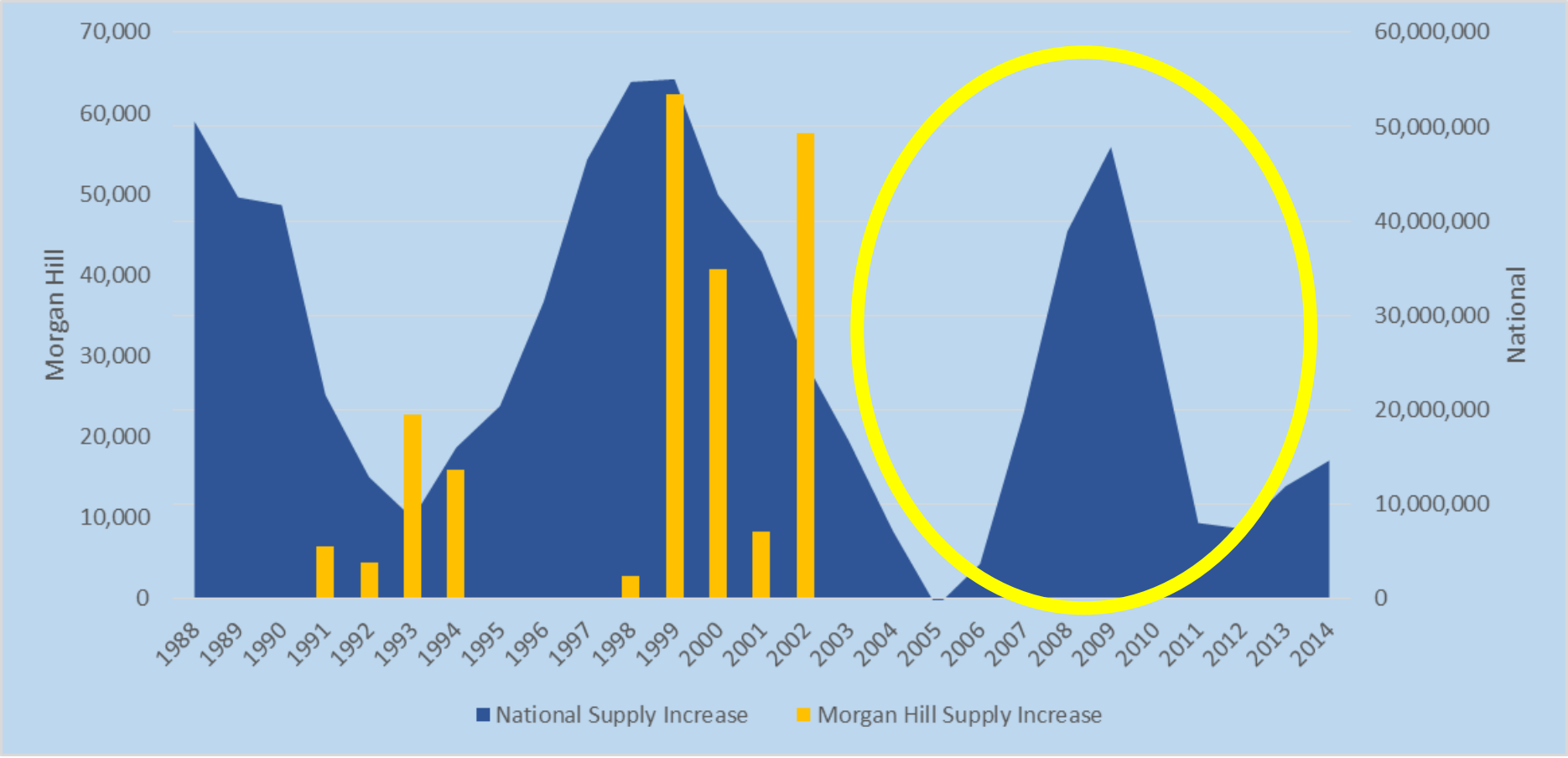
Top 5 Hotels
Others

Source: City of Morgan Hill



Supply growth is cyclical...

...but Morgan Hill missed the last cycle

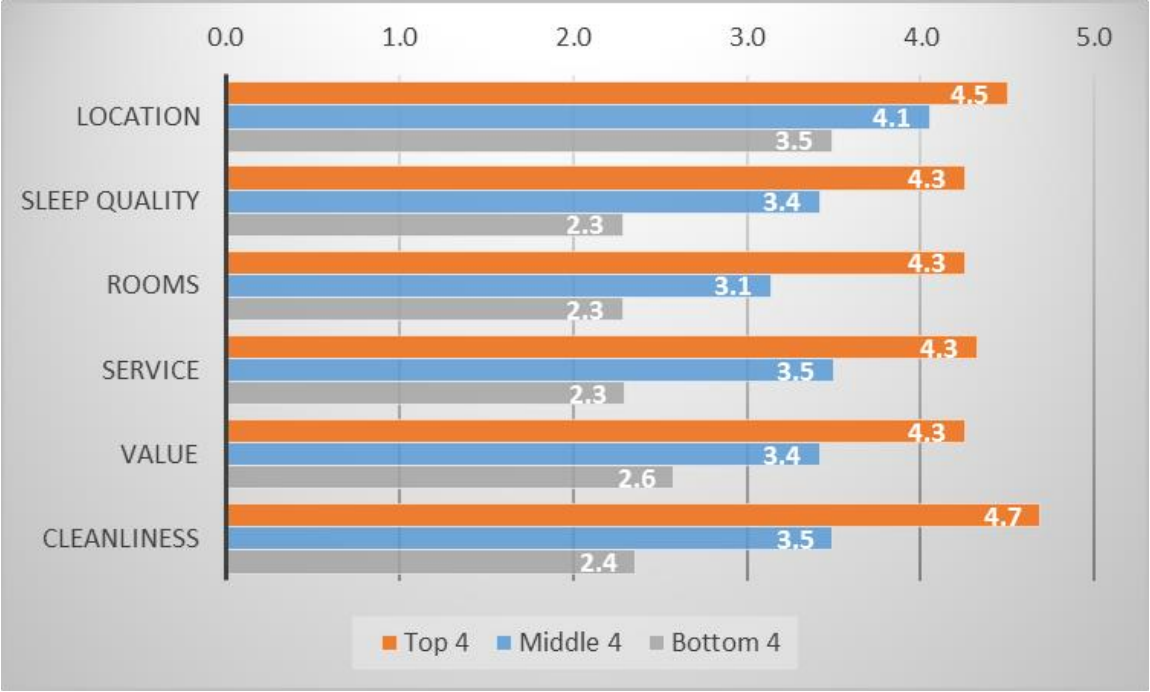
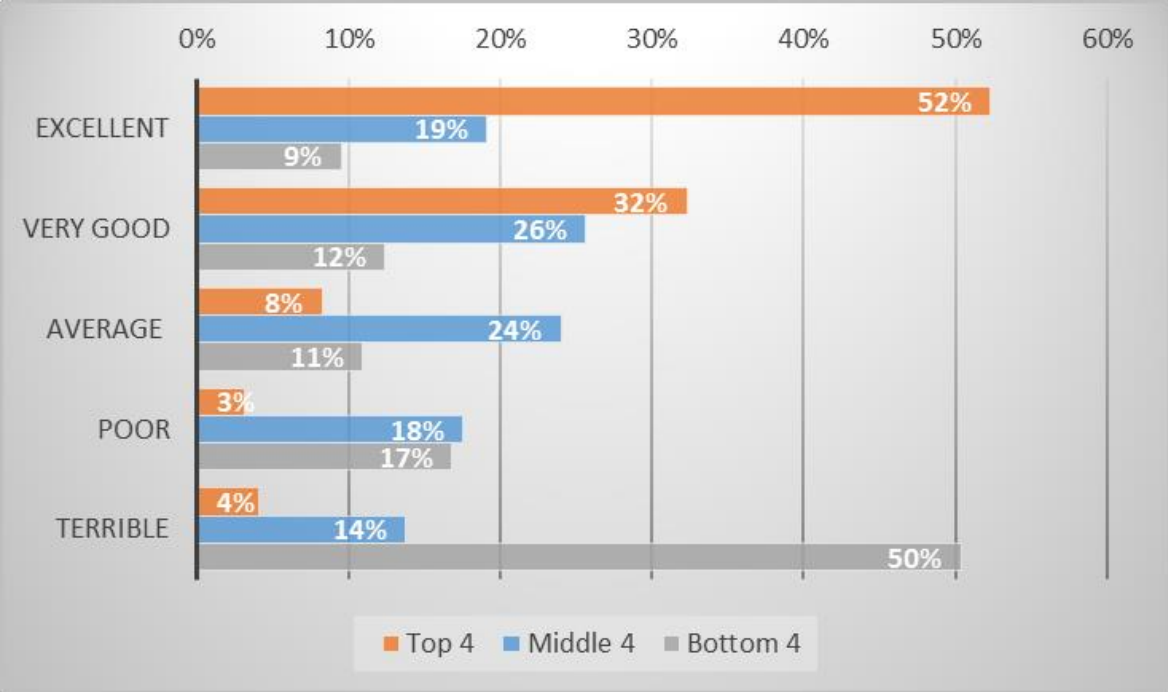


Source: STR, HA&A



Wide gaps in hotel review scores...

...newer properties receive best scores

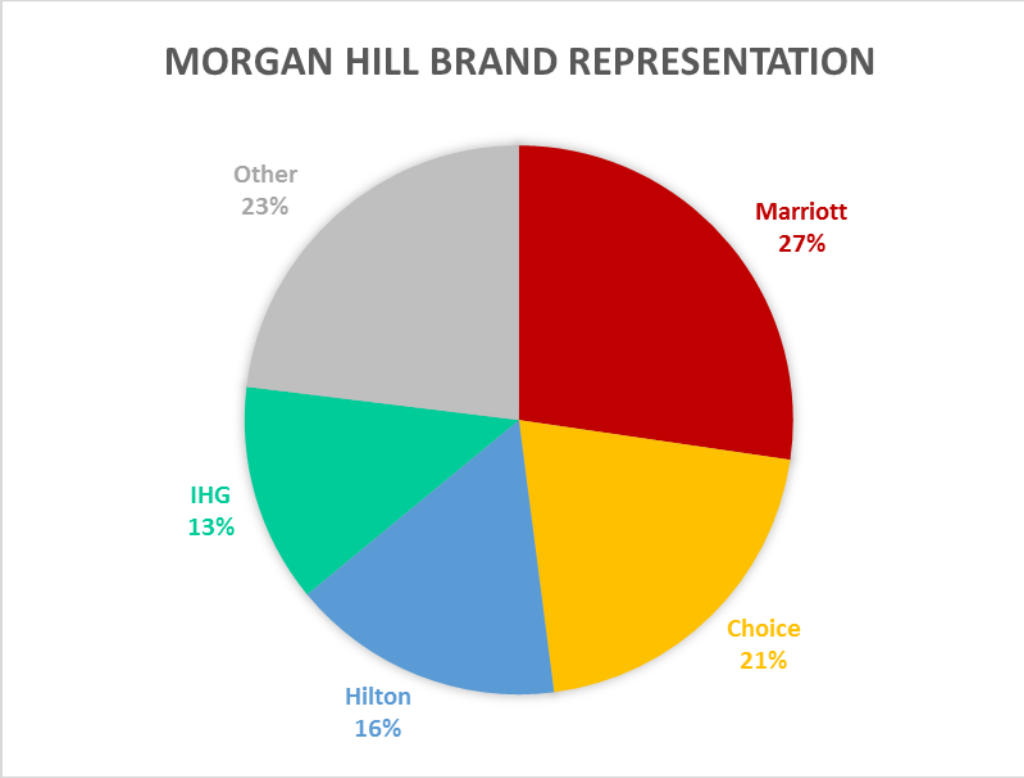
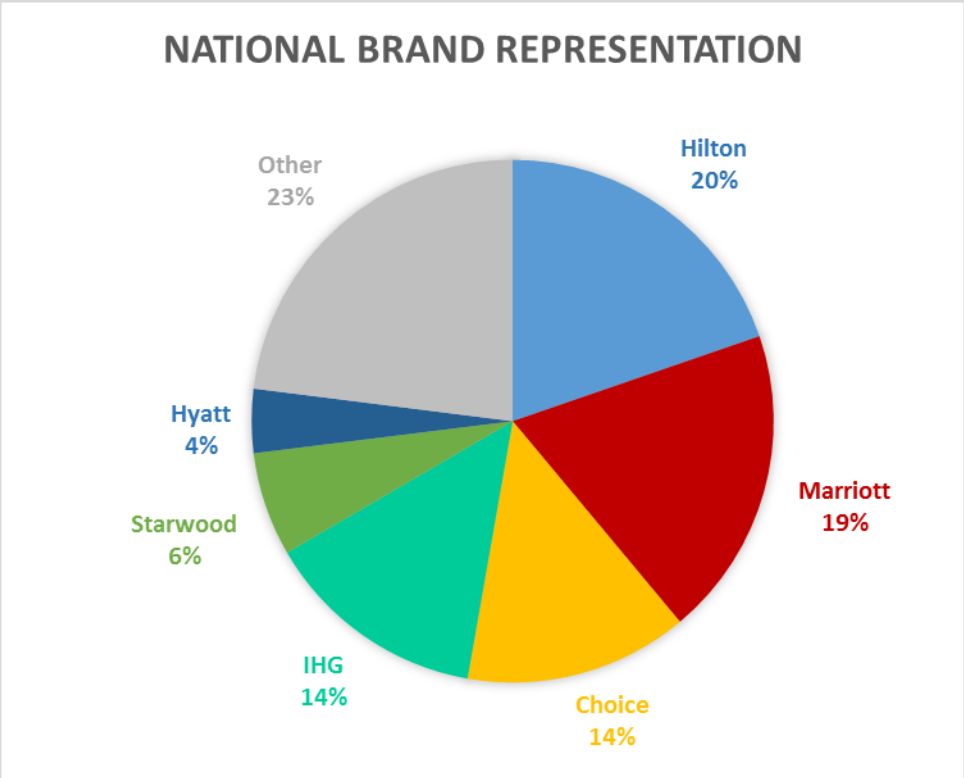


Source: TripAdvisor, HA&A

* The Holiday Motel was excluded from the ranking because there is no entry for the hotel on TripAdvisor



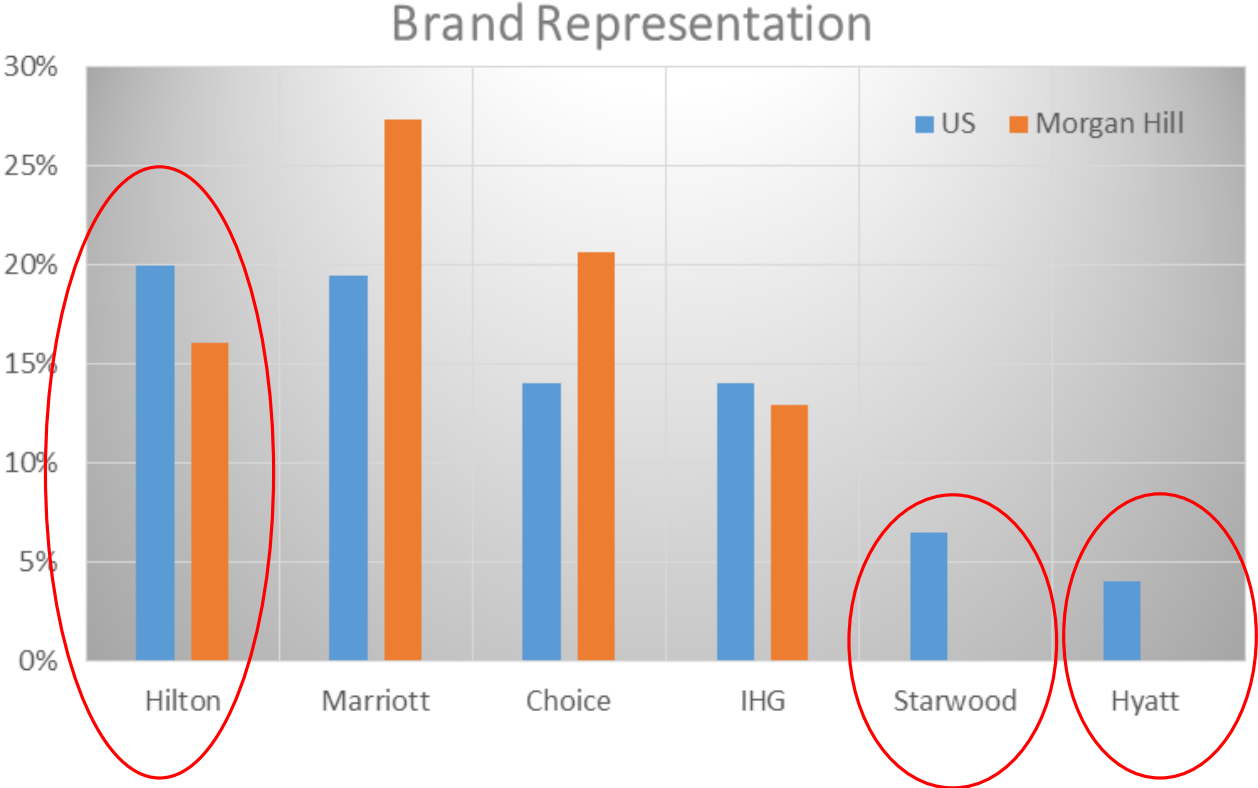
Some brands are under-represented in Morgan Hill... ...potential opportunity for Hilton, Starwood, Hyatt brands



Source: STR, HA&A Data Library



Hilton, Starwood, and Hyatt brands are underrepresented currently



Source: STR, HA&A Brand Library



Developers seek markets that can support...

...RevPARs above brand averages

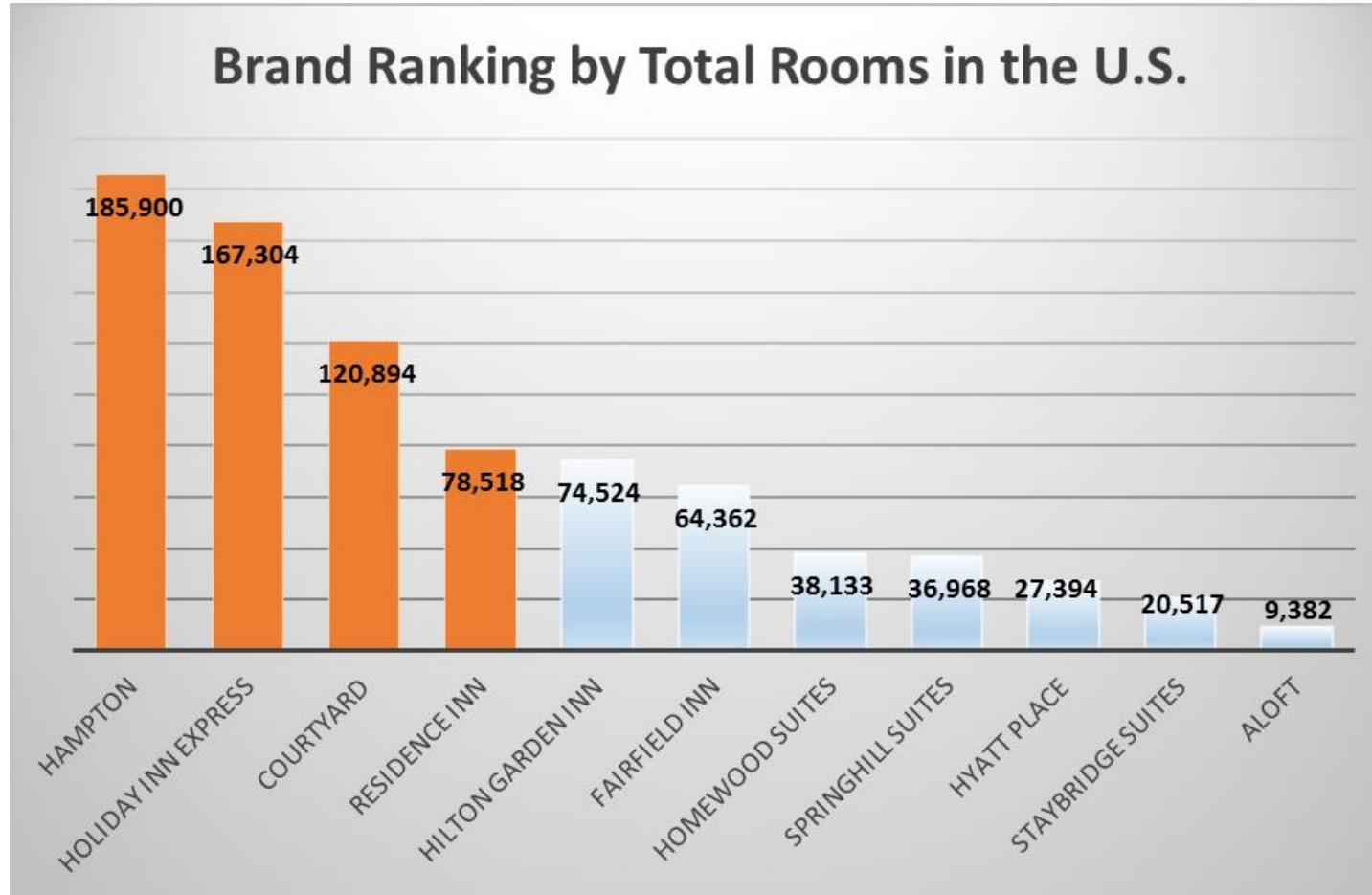
Brands	Occupancy	ADR	RevPAR
Hyatt House	79%	132.92	105.41
Hotel Indigo	73%	136.36	98.86
Homewood Suites	79%	125.13	98.73
Hilton Garden Inn	75%	126.08	94.94
Aloft	76%	123.32	93.48
Staybridge Suites	78%	111.34	86.73
Hyatt Place	76%	112.24	85.30
Home2 Suites	79%	106.9	84.45
SpringHill Suites	75%	112.16	83.67
TownePlace Suites	75%	96.84	72.34
Fairfield Inn	70%	102.8	72.06
Holiday Inn	66%	107.56	70.77

← Top 5 RevPAR (\$96.42)



Four top brands already exist in Morgan Hill...

...missing brands may present opportunities



Source: HA&A Data Library and Franchise Disclosure Documents



Thank you!

Addendum

1. Address market demand for our community – with clear understanding of our community dynamics, vision, challenges and opportunities.

Morgan Hill is experiencing a growth phase of an economic cycle, after a rapid recovery from the global recession. As shown on slide 20, Morgan Hill is in its 6th consecutive year of lodging demand growth. After the Dot Com bubble burst, it took Morgan Hill until 2007 to achieve a new peak level of demand. With the most recent recession, demand declined from the 2007 peak. Then a new peak was achieved in 2012. New demand peaks were set in 2013 and 2014. Year-to-date 2015 suggests another record-setting year.

2. Address the impact of more hotel rooms to the TOT, analyzing a long-term historical period of supply and demand in Morgan Hill to evaluate whether supply growth historically has been correlated with demand growth. Analyze a long-term STR trend to see whether this is also true in Morgan Hill historically. Demonstrate this correlation graphically. Order a national STR trend report as a control group to isolate what portion of demand growth is due to national economic growth versus local supply growth.

We estimate total rooms revenue of approximately \$41.6 million was added in Morgan Hill due to the addition of new supply (Courtyard and Residence Inn) between 2000 and 2014. In 2014, rooms revenues were about \$5 million higher than they would have been if this new supply had not been introduced to the market. This represents a significant positive impact for TOT.



- 3 Analyze supply and demand trends for the high-performing competitive set in Morgan Hill. Order a custom trend report from STR to evaluate how just the top 4-8 hotels are performing to see how new developers are looking at this market and whether they see development potential here.

The local market data indicate opportunities for potential hotel developments in Morgan Hill, as occupancy levels have exceeded 70% for top performers in recent years. Moreover, RevPAR levels have exceeded \$90 for top performers in recent years, suggesting potential for additional upscale hotel development. Please refer to slides 22.

4. Analyze whether “unaccommodated” demand or “pent up” demand exists in the Morgan Hill market, and demonstrate some ways to quantify this or at least discuss whether a significant volume exists in this market.

A substantial amount of unaccommodated is estimated to exist in the Morgan Hill market, which should moderate the impact from potential new supply. Please refer to slide 29 and 30.



5. Discuss what “new supply” circumstances can also bring “induced” demand in addition to unaccommodated demand.

When hotel brands which are new to the market are introduced, a new hotel can potentially induce demand due to its reservation system and sales team that was previously unrepresented in the local market. There are major brands missing from Morgan Hill, which present opportunities for potential hotel development. Please refer to slide 34, 35, 36, and 37.

6. Assess the local inventory of hotels and categorize Morgan Hill’s lodging inventory by Hotel Company, Brand, Chain Scale, and Age. Comment on what’s missing, if anything. Discuss general performance parameters required by those brands and chain scales that are currently missing. Compare these general performance parameters with Morgan Hill’s top-tier “competitive set” identified in #3 above.

Morgan Hill features three “upper midscale” brands currently. Some notable brands not represented in this chain scale include Fairfield Inn, TownePlace Suites, and Home2 Suites. Morgan Hill features two “upscale” brands currently. Some notable brands not represented in this chain scale include Hilton Garden Inn, Homewood Suites, Hotel Indigo, SpringHill Suites, Staybridge Suites, Hyatt Place, Aloft, and Cambria Hotel & Suites. Please refer to slides 34, 35, 36, and 37.



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