THE PLASENCIA GROUP
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Q4 2016

MARKET FOCUS: TEXAS

October 26, 2016

The Lone Star State is a market like no other, comprised of four major cities and numerous, distinct submarkets within those. With a diverse set of demand drivers, ranging from finance to energy, medicine and tourism, Texas continues to attract business and leisure travelers from around the country and globe. While performance figures are strong in many markets, challenges remain for hotel and resort owners in certain areas, especially those experiencing meaningful supply growth.

We prepared this issue in our Market Focus series with insights gleaned from industry experts, hotel owners and investors from Texas and elsewhere. We thought it important to share what we have learned with our clients and friends who have an interest in Texas investments, own lodging assets in the state, or both.

Whether an institutional investor or an independent owner, we hope that the information contained in this report serves to be both informative and compelling. As always, we welcome the opportunity to discuss your hotel and resort holdings with you, whether in Texas or elsewhere.

New Supply: Not Always a Downer

Conventional wisdom dictates that new supply is a threat to hotel operations, but recent history in several Texas markets seems to defy logic in cases where economic expansion continues to outpace and accommodate the new supply. Austin offers perhaps the best evidence of this; of Texas' four major cities (Houston, Dallas, Austin and San Antonio), Austin has seen the largest jump in supply since 2007. However, since its economy (shown on the following page in terms of employment) has also grown more than any other major Texas city's, Austin has achieved the greatest RevPAR growth of the group. On the opposite end of the spectrum, San Antonio is the only one of the four cities that has seen hotel supply growth exceed employment growth. Not coincidentally, it has the lowest RevPAR growth since 2007.

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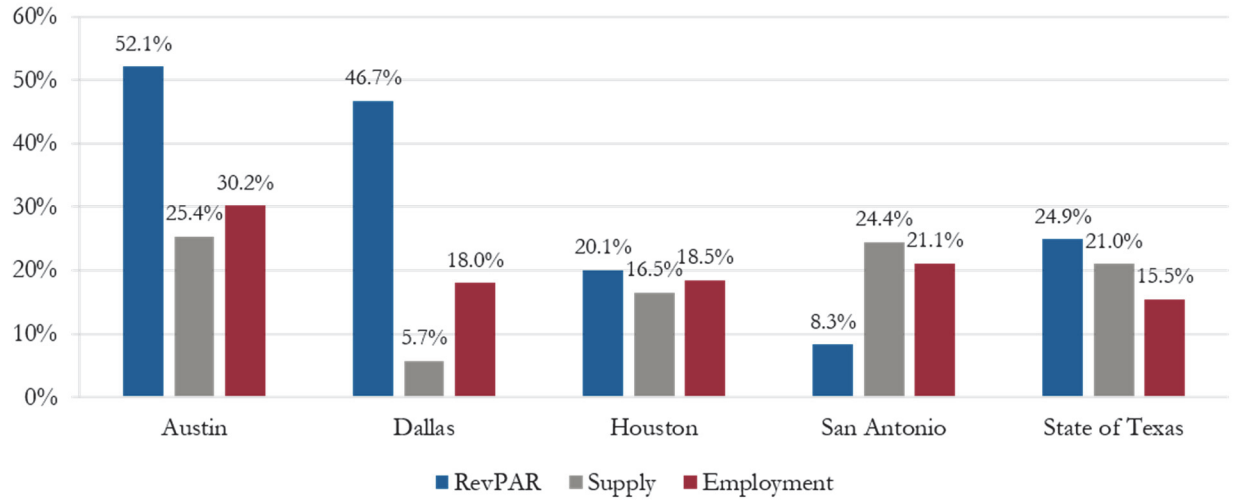
Prior Peak to Current Lodging Sector and Employment Growth



	Austin	Dallas	Houston	San Antonio	State of Texas
2007 Year-End (Prior Peak)					
RevPAR	$74.35	$57.80	$62.97	$68.18	$52.44
Supply (Rooms)	20,409	28,358	47,276	31,520	356,239
Employment	822,013	3,005,252	2,620,646	893,253	10,997,356
June 2016					
RevPAR (T-12)	$113.07	$84.81	$75.63	$73.83	$65.50
Supply (Rooms)	25,585	29,961	55,100	39,214	430,919
Employment	1,070,576	3,547,553	3,106,410	1,081,678	12,705,966

Sources: Source Strategies, U.S. Bureau of Labor Statistics

Houston Not Improving Anytime Soon

The operational and financial restructuring of Houston's energy sector is not over and employment reductions and financial distress will continue. Financial institutions have essentially "red-lined" Houston-area new development lending activity. Investor interest in Houston remains somewhat active but is focused almost exclusively on hotels that can be purchased using current market metrics. Very few owners, however, are willing to even consider a transaction using current performance measurements. Houston is currently the poorest RevPAR performer among STR's Top 25 markets after performing strongly in 2013 and 2014, as shown on the following page.

Very few owners in Houston are willing to consider a transaction using current performance measurements.

All that said, many energy sector participants anticipate energy prices will increase during 2017 to roughly $60 per barrel. Certain sectors of Houston's regional economy continue to experience increases in employment, including the medical, petrochemical and professional services fields. The current down cycle is not as devastating to the local and regional economies as the down cycle that occurred in the mid-1980s.

STR Top 25 Market Performance

2013		2014		2015		August 2016 YTD	
Market	**% Change**	**Market**	**% Change**	**Market**	**% Change**	**Market**	**% Change**
Houston	13.8%	Nashville	19.0%	Tampa	13.8%	Los Angeles	11.8%
Nashville	13.4%	Denver	16.2%	Phoenix	12.8%	Nashville	9.0%
San Francisco	12.9%	Atlanta	13.1%	Nashville	11.1%	Dallas	7.6%
Oahu Island	12.5%	San Francisco	12.6%	Dallas	10.0%	Norfolk	7.5%
Dallas	10.8%	Seattle	12.6%	Anaheim	9.4%	Philadelphia	7.4%
Miami	10.1%	Tampa	12.0%	Atlanta	9.3%	Tampa	7.0%
Denver	8.6%	Boston	10.8%	Orlando	9.1%	San Francisco	6.3%
Anaheim	8.5%	Orlando	10.7%	Los Angeles	8.8%	Atlanta	4.9%
Seattle	7.9%	Phoenix	10.5%	Seattle	8.8%	Anaheim	4.6%
Orlando	7.8%	Los Angeles	10.3%	San Diego	8.6%	Detroit	4.2%
St. Louis	7.3%	St. Louis	10.0%	Boston	7.9%	Minneapolis	3.4%
Minneapolis	7.2%	Detroit	10.0%	Denver	7.9%	Oahu Island	3.1%
Detroit	7.0%	Houston	9.7%	San Francisco	7.5%	Washington, D.C.	3.0%
Los Angeles	6.8%	Anaheim	9.5%	Norfolk	7.4%	Denver	3.0%
New Orleans	6.6%	San Diego	9.4%	Chicago	6.9%	St. Louis	2.9%
Phoenix	6.3%	Dallas	9.0%	Detroit	6.6%	Phoenix	2.7%
Atlanta	6.1%	Minneapolis	7.5%	Miami	6.0%	San Diego	2.2%
Boston	5.6%	Chicago	7.1%	Minneapolis	5.8%	Seattle	2.1%
Chicago	4.4%	Miami	7.0%	Philadelphia	5.5%	Orlando	1.1%
San Diego	4.2%	Oahu Island	6.5%	Washington, D.C.	5.4%	Boston	-0.7%
New York	4.1%	Washington, D.C.	5.2%	St. Louis	5.3%	Chicago	-2.2%
Tampa	3.1%	Norfolk	5.0%	Oahu Island	4.1%	New Orleans	-2.5%
Norfolk	-0.6%	Philadelphia	4.7%	New Orleans	3.4%	New York	-2.8%
Philadelphia	-0.9%	New Orleans	4.6%	New York	-1.7%	Miami	-3.3%
Washington, D.C.	-1.7%	New York	2.3%	Houston	-3.3%	Houston	-10.7%

Source: Smith Travel Research

Development Means More Hotel Demand for North Dallas Suburbs

The Dallas market is currently one of the strongest markets in the U.S. in terms of RevPAR growth. Within the greater area, several suburban submarkets are performing especially well and are attractive to investors, including the northern suburbs of Frisco and Plano.

The local economies of these two cities are being catalyzed by the development of "The Five Billion Dollar Mile," a stretch of mixed-use developments located in Frisco. These developments include The Star, which is anchored by the Dallas Cowboys' new world headquarters, an Omni hotel, and a multi-use event facility; Frisco Station, which offers six million square feet of office space, along with restaurants, retail and residential; The Gate, which features four million square feet of office space, dining, retail and

residential; and Wade Park, a 175-acre mixed use development with office, retail, hotel and residential components. Plano also benefits from the relocation site of Toyota's 100-acre North American Headquarters. The campus should be completed and occupied by 6,500 employees by the third quarter of 2017. The developments of offices for Liberty Mutual (4,000 employees) and JP Morgan Chase (6,000 employees) are also underway in Plano.

Richardson is another northern suburb that stands to benefit from substantial commercial development. Construction was recently completed on a massive State Farm Insurance complex in the city. Over 8,000 State Farm employees will work at the campus, which also includes 30,000 square feet of retail space and a parking garage.

With these new developments, these submarkets should significantly improve upon historical performance, which is shown below along with the performances of other Dallas suburbs.

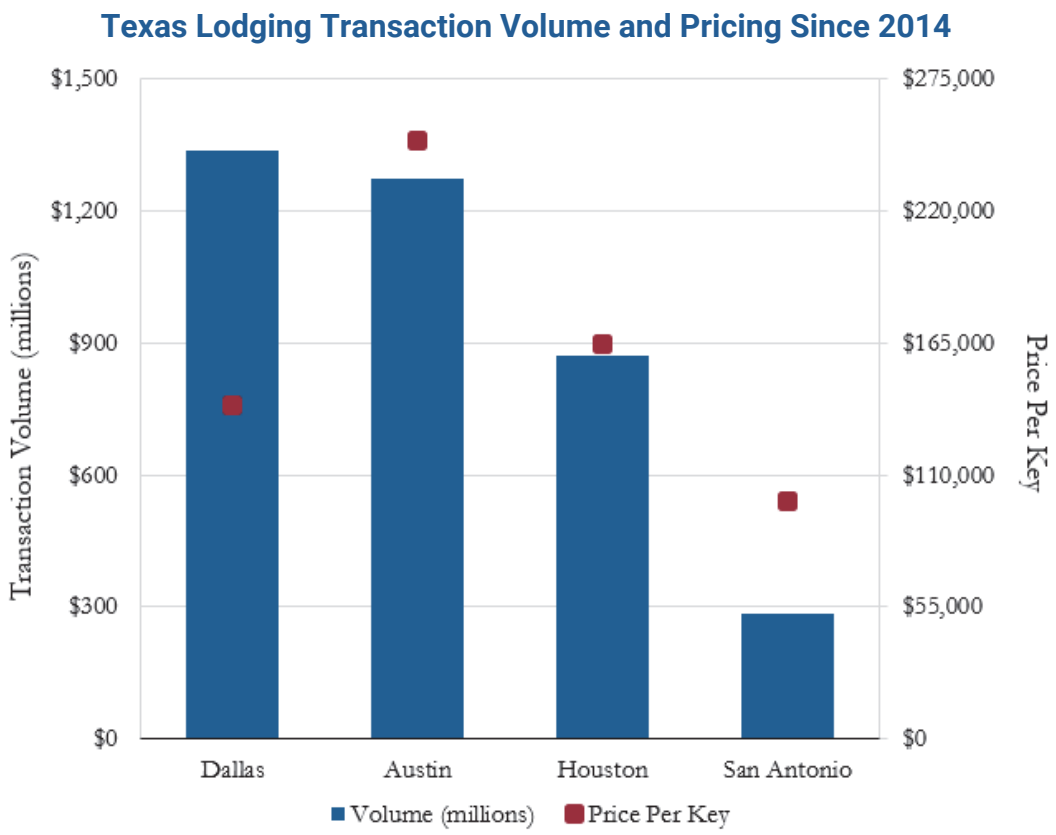
Historical RevPAR by Dallas Submarket

Market	Rooms	2011	2012	2013	2014	2015	June 2016 T-12
Grapevine	5,407	$102.38	$103.33	$108.11	$112.66	$128.58	$129.06
Frisco	2,002	$82.48	$82.60	$91.05	$94.63	$95.56	$96.43
Dallas	29,961	$59.20	$62.66	$70.20	$74.87	$81.61	$84.81
Irving	11,669	$57.48	$59.53	$64.37	$69.57	$75.23	$77.07
Richardson	2,447	$52.85	$52.54	$59.68	$64.05	$70.42	$75.26
Metro Dallas	75,434	$51.16	$53.87	$59.57	$64.36	$70.26	$73.09
Plano	5,172	$50.28	$50.58	$56.40	$62.56	$68.74	$71.70
Addison	4,074	$49.03	$52.02	$54.74	$60.52	$68.31	$71.40
Fort Worth	12,514	$58.43	$59.14	$61.53	$66.76	$68.86	$70.38
Arlington	6,041	$45.89	$48.89	$51.29	$54.13	$58.03	$61.77
Lewisville	2,616	$36.70	$41.63	$42.84	$46.00	$51.84	$54.53

Source: Source Strategies

Austin and Dallas Remain Most Attractive Hotel Investment Markets in Texas

With more stable operational profiles than Houston and San Antonio, Austin and Dallas have seen the most transaction activity in Texas since 2014, as shown on the next page. A few hotels in Houston have traded, though those were "situational" purchases or were acquired by purchasers with a longer-term investment horizon. The Austin transaction market has remained strong due to the high level of "permanent" demand emanating from education, government and high-tech. In fact, outside of gateway markets like Northern California, New York City and Miami, Austin's average price per key of almost $250,000 was one of the highest in the U.S. This is largely due to the city's emergence as a major convention and leisure destination, along with its status as a state capital and the fact that it is home to the University of Texas, one of the largest universities in the country.



Source: Real Capital Analytics

Challenges Remain

As astute investors well know, it is virtually impossible to find a single market that can offer opportunities without offsetting challenges. While the future for Texas hotels is promising, a few areas of concern are noteworthy:

- Property tax increases loom as many appraisal districts throughout the state, and nation, are actively tracking transaction records to justify higher value assessments for their current real estate rolls.
- Upward pressure on wages is affecting budgets for 2017 and projections beyond that. With the proliferation of new rooms in some markets, operators are beginning to experience upward pressure on wages to maintain high quality staffs.
- Airbnb is no passing fad and will continue to disrupt the hotel industry. This service, along with the rest of the peer-sharing economy, is here to stay. Some hoteliers are even experimenting with offering unbooked rooms through these services, opting to work with the trend instead of fighting it. Meanwhile, major lobbyists continue to fight for the fair collection of bed taxes in many currently unregulated or under-enforced municipalities.
- A prolonged energy sector slump continues to impact Houston, and should this downtown continue for many years, it will eventually spread to non-energy markets and submarkets.

Summary

There aren't any sweeping generalizations that should be applied to all of the markets and submarkets that make up the Texas lodging investment environment. The same goes for your hotel and resort investments—no two are the same.

Depending on your investment plans, it may be prudent to consider the sale of a hotel in markets where values remain high. Conversely, you may be interested in acquiring a hotel in a market where historically stable properties are available at a meaningful discount to replacement cost.

Whether you're seeking advice on the sale, purchase or financing of an asset in Texas, please don't hesitate to give our team a call. Dozens of companies and individuals, many of them repeat clients, have entrusted The Plasencia Group with dispositions, asset management and other consulting engagements across the state. Our history of completed engagements in Texas, along with our nationwide reach positions our team for continued success in the Southwestern United States and beyond.

Please visit our website at tpghotels.com for more information on our team, track record and capabilities. As always, please drop me a note at lplasencia@tpghotels.com with your feedback and questions. Best wishes through the holidays and into the New Year!

THE PLASENCIA GROUP, INC.

Lou Plasencia
Chief Executive Officer

(813) 932-1234
lplasencia@tpghotels.com

Relevant Engagements by The Plasencia Group

The Plasencia Group has been active in the the Lone Star State since 1994, with three full-time lodging investment professionals positioned in Houston and Dallas currently. The team has completed nearly 100 dispositions in Texas, representing nearly 20,000 hotel rooms and over $1.1 billion transacted.

Based in Houston, Mr. Robert Wiemer is the nation's all-time leading investment specialist for full-service hotel transactions in the Southwest United States. Mr. Joe Corcoran and Mr. Paul Williams, both based in Dallas, also support clients' needs in Texas and across the country.

Houston Marriott West Loop
Houston, TX | 302 Keys
R. M. Crowe

Sheraton DFW Airport
Dallas, TX | 300 Keys
Starwood Hotels & Resorts

Omni Corpus Christi
Corpus Christi, TX | 346 Keys
Omni Hotels & Resorts

InterContinental Austin
Austin, TX | 189 Keys
InterContinental Hotels Group

Hilton Garden Inn Dallas Market Center
Dallas, TX | 240 Keys
Songy Highroads

DoubleTree Houston Galleria
Houston, TX | 380 Keys
Kimco/Westmont Hospitality

Embassy Suites San Antonio NW I-10
San Antonio, TX | 216 Keys
FelCor Lodging Trust

Hilton Suites Dallas
Dallas, TX | 258 Keys
Herrington Hotels

DoubleTree Lincoln Center
Dallas, TX | 500 Keys
MetLife Real Estate Investors

Sofitel Houston
Houston, TX | 334 Keys
Accor Hotels

Hampton Inn Houston Near the Galleria
Houston, TX | 176 Keys
Ashford Hospitality Trust

Embassy Suites San Antonio Airport
San Antonio, TX | 261 Keys
FelCor Lodging Trust

Embassy Suites Corpus Christi
Corpus Christi, TX | 150 Keys
FelCor Lodging Trust

Hyatt Place Dallas/Grapevine
Grapevine, TX | 125 Keys
Moody Companies

Sheraton North Houston at Bush Intercontinental
Dallas, TX | 300 Keys
Starwood Hotels & Resorts

DoubleTree Houston Intercontinental Airport
Houston, TX | 313 Keys
Crow Holdings