



**PHASE I  
COMMUNITY OVERVIEW  
MARKET STUDY REPORT**

**Arlington, Minnesota  
July, 2006**

**Prepared Exclusively For:**

**Mr. David L. Krueger, City Administrator  
City of Arlington, Minnesota**

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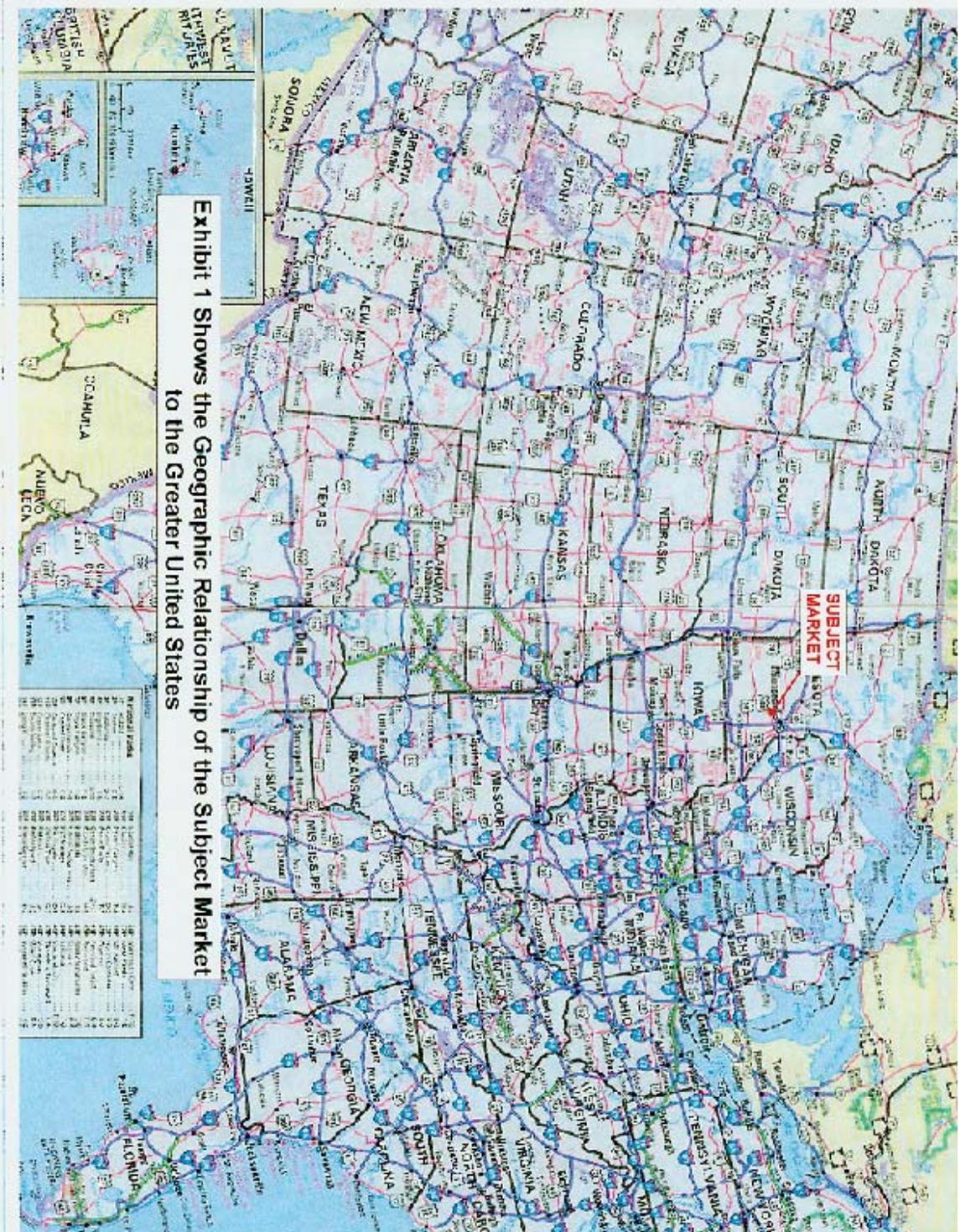
# **TABLE OF CONTENTS**

## **Arlington, Minnesota**

<b>Introduction/ Objective.....</b>	<b>1-2</b>
<b>General Market Description .....</b>	<b>3-4</b>
<b>-Community Characteristics</b>	
<b>-Exhibits</b>	
<b>Site Analysis.....</b>	<b>5-6</b>
<b>Economic Overview.....</b>	<b>7-8</b>
<b>-General Economic Trends</b>	
<b>-Workforce Characteristics</b>	
<b>-Unemployment Rates</b>	
<b>-Transportation</b>	
<b>Lodging Demand.....</b>	<b>9-14</b>
<b>-Market Segmentation &amp; Profiles</b>	
<b>-Seasonality of Lodging Demand</b>	
<b>-Lodging Demand Potential Index</b>	
<b>-Unaccommodated Lodging Demand</b>	
<b>Lodging Supply.....</b>	<b>15-18</b>
<b>-Competitive Lodging Performance</b>	
<b>-Proposed Properties</b>	
<b>Issues and Risks.....</b>	<b>19-20</b>
<b>Conclusions .....</b>	<b>21-26</b>
<b>-Property Recommendations</b>	
<b>-Property Type</b>	
<b>-Property Size</b>	
<b>-Property Amenities</b>	
<b>-Sleeping Room Configuration</b>	
<b>-Brand Affiliation</b>	
<b>-Room Rate Strategy</b>	
<b>-Opening Date</b>	
<b>-Projected Property Performance</b>	
<b>-55 Room Property</b>	
<b>-Maximum Allowable Development Costs</b>	

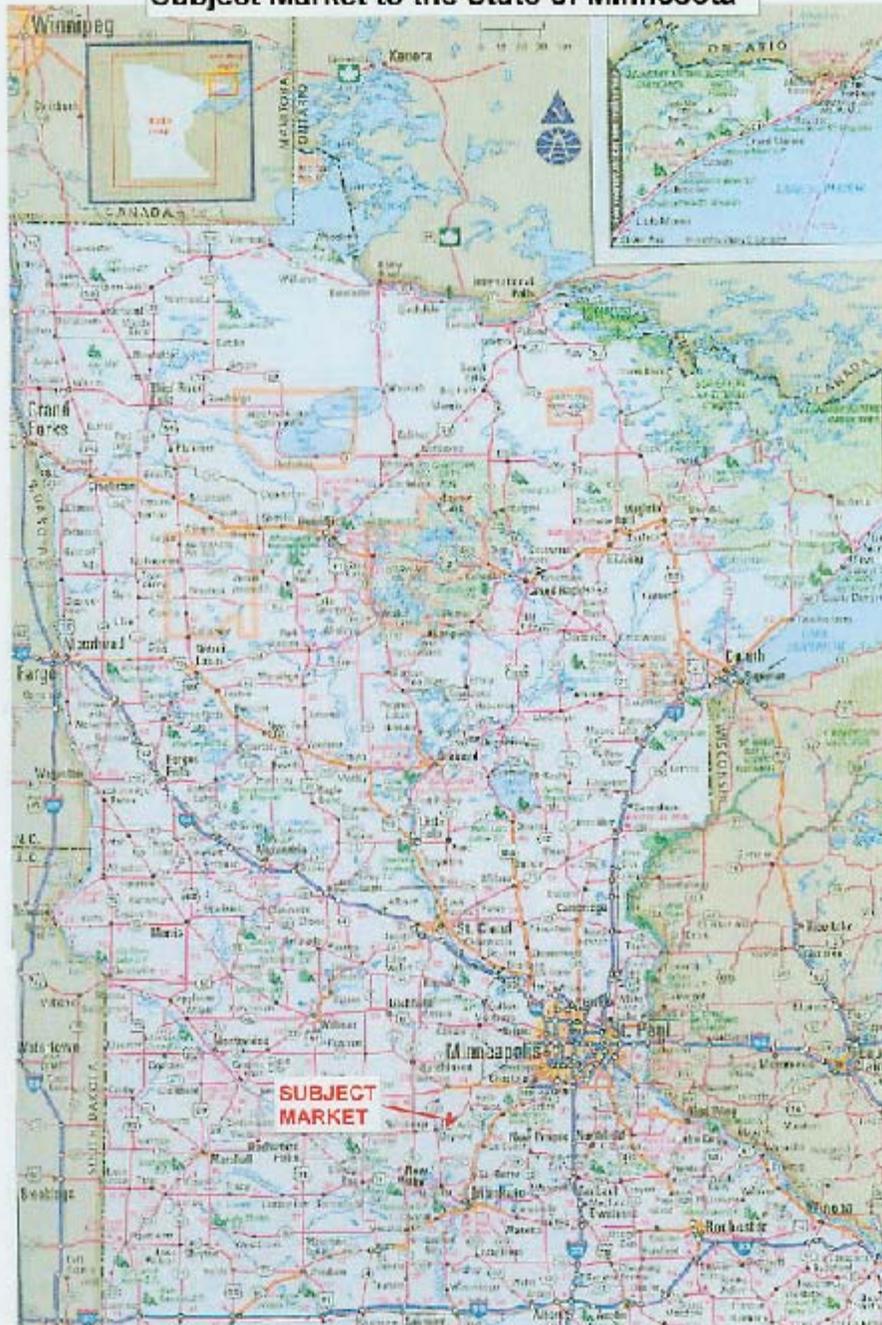
## **EXHIBITS**

- EXHIBIT 1 - Geographic Relationship of the Subject Market to the Greater United States**
- EXHIBIT 2 Geographic Relationship of the Subject Market to the State of Minnesota**
- EXHIBIT 3 - Primary Competitive Hotels in Relationship to the Proposed Hotel Including Highlighting the Primary Market/Regional Area that will be Served**
- EXHIBIT 4 - Geographic Location of the Three Sites Under Consideration during Discussions with Local Officials**

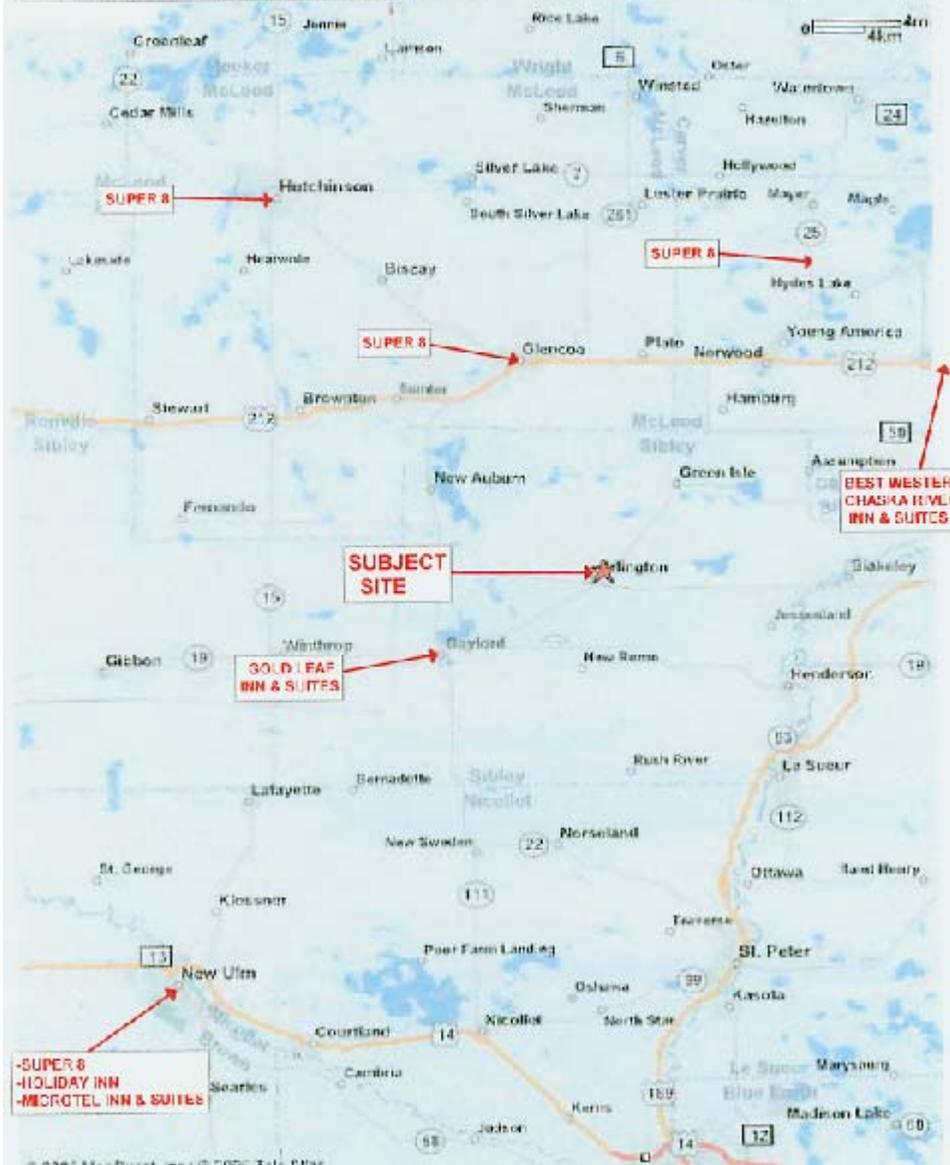


**Exhibit 1 Shows the Geographic Relationship of the Subject Market to the Greater United States**

**Exhibit 2 - Geographic Relationship of the Subject Market to the State of Minnesota**



**Exhibit 3 - Shows the Primary Competitive Hotels to the Proposed Hotel and Highlights the Primary Market/Regional Area**







## **INTRODUCTION/OBJECTIVE**

Hospitality Marketers International, Inc., (HMI) has been engaged to provide this Phase I Community Overview Market Study Report analysis for a possible limited-service hotel development in the Arlington, Minnesota area. Three specific areas in the Arlington market area were identified by local officials as potential sites for the proposed hotel, however, only one is currently owned by the city and is the focus of this report. No specific site has been identified at this time. The size of the proposed hotel has not yet been determined, so recommendations regarding the size will be included in this report.

This Market Study will provide an overview of market information concerning the Arlington, Minnesota area and the market factors that would affect the possible development of a hotel facility in the specified market area. It is written in an overview format that will highlight key information to provide a preliminary indication of this market's ability to support the proposed hotel development. This report could be expanded, at a later date by the developer, to a Phase II Comprehensive Market Study of the specific site selected. The Phase II Comprehensive Market Study would provide comprehensive supportive data, observations, and research of the market. Also, more detailed property recommendations and projections of property performance would be presented.

As stated, the scope of the report is to provide an overview of the market and a consultant's opinion concerning the community and its ability to support a hotel. A representative from Hospitality Marketers International, Inc., met with representatives of the community and the surrounding area to gather information pertinent to hotel development and operation in the community. Comprehensive research was performed and reviewed regarding the community's economic indicators, competitive Lodging Supply, and Lodging Demand generators. HMI conducted field research to determine the relationship between the community and the proposed facility's Lodging Supply competitors and Lodging Demand generators. Economic indicators were studied to determine the stability and future growth potential of the general market area. The research that was conducted focused on macro- and micro-market analysis of the Arlington, Minnesota market areas to determine the viability of this market to support the proposed hotel.

This report will present preliminary projections for stabilized hotel operation based upon current operating performance in the market area. Preliminary Occupancy, Average Daily Room Rate, and Sales Revenue projections for the hotel were based upon a detailed review of the field research data and preliminary estimates of Average Daily Room Rate, Lodging Demand, and Lodging Supply Growth. Also, preliminary recommendations as to the property type, suggested property size, brand affiliation, and services and amenities to offer are included. These projections and recommendations were based upon the market demand research for the proposed facility. In addition, preliminary recommendations are provided as to the preferred site for development for this hotel project.

This study is provided as a preliminary report regarding an overview of the market area and discusses its ability to support hotel operations. This report may or may not be acceptable for external investing and/or lending purposes, and would depend upon lending and/or investing requirements and the desire for more specific information concerning this market's ability to support this hotel. Also, more specific operational performance projections may be required. Additional specific community research for a defined hotel project may need to be completed for a specific hotel development. A Phase II Comprehensive Market Study may be required by investors and lenders for the specific hotel to be developed. Hospitality Marketers International, Inc. could assist a proposed hotel developer in expanding this report into the required Phase II Comprehensive Market Study Report.

## **GENERAL MARKET DESCRIPTION**

The subject market area of this study for a proposed limited-service hotel without food and beverage services is the City of Arlington, Minnesota. It is located approximately forty-five miles or 45-50 minutes southwest of the Twin Cities metro area.

Arlington is a smaller rural community with a population of approximately 2,300 to 2,450 people.

The current main travel route to the area is via US 212 from the Twin Cities to the northeast and then Minnesota State Highway 5, which runs through downtown Arlington and on to Gaylord and Redwood Falls to the west. Scheduled improvements to US 212 in 2009 will make it four lanes from the Twin Cities to where it intersects with Minnesota State Highway 5, facilitating this area in becoming one of the next major growth suburbs for the Twin Cities.

The economic base for the area, be it Arlington or Sibley County, is split between Agriculture and Manufacturing. The Manufacturing sector is comprised of a few smaller to medium-sized companies in Arlington and nearby communities such as Gaylord. Residents of Arlington commute either north to the Twin Cities or south to Gaylord or Mankato for work if not employed locally. The Retail in Arlington includes smaller shops, there are no big box retailers. The Service areas such as Education and Health as well as the Retail sector closely follow the Manufacturing area in size. Employment in the area is supported by the strong German heritage of its residents and their strong work ethic. There is a growing Hispanic population in the area as well.

Recreation in the Arlington area includes the Arlington Raceway with races every Saturday evening during May through September, as well as the County Fair Grounds and a championship high school baseball team. The Minnesota River and several lakes are within a ten mile radius, providing outdoor water activities. There are also two casinos within an hours drive of Arlington as well as three golf courses within fifteen miles of Arlington.

There is one small 10-room motel in Arlington which is in poor condition and is presumed to cater mostly to the employees of its owner with "monthly" business. The closest traditional lodging facilities are either eight miles to the south in Gaylord as a small independent property or twelve to fifteen miles in several directions in Glencoe or Belle Plaine.

This area has seen slow, but steady growth historically. However, due to its proximity to the Twin Cities, Sibley County is anticipated to experience a 20% growth rate by 2030, per the Minnesota Department of Administration, with the Eastern portion of the county, which includes Arlington to, have an even higher growth rate. This is also due to the completion of the Highway 212 Eden Prairie/Chaska bypass in 2008, which greatly enhances the ease of traffic flow in and out of the Twin Cities area.

The following exhibits will describe the geographic location of this market and subject site.

- Exhibit 1 of this report shows the geographic relationship of the subject market to the Greater United States.

- Exhibit 2 of this report relates the geographic relationship of the subject market to the State of Minnesota.
- Exhibit 3 of this report shows the primary competitive hotels in comparison to the proposed hotel and highlights the primary market/regional area that will be served.
- Exhibit 4 of this report shows the location of the three sites under consideration and that were mentioned during discussions with local officials.

## **SITE ANALYSIS**

This section of the report will highlight the proposed geographic subject sites identified for the proposed hotel facility. Discussions with city officials indicated three possible site areas, with one being “preferred” by them due to it being the only currently owned by the city, which would provide the city with a greater ability to work out a deal with a developer. Key elements of the site analysis will be discussed including Visibility, Accessibility, Support Services, and Competitive Position. The following will highlight key factors for the subject sites. Additional information related to a specific hotel development would be provided in a Phase II Comprehensive Market Study.

Site 1 – This site is the one site currently owned by the city and is located on the south side of Arlington in the northeast quadrant of the intersections of State Highway 5 and County Route 9. It is located less than one mile from downtown Arlington on the west/north side of State Highway 5 with very good visibility.

The city’s ownership of this site makes it the site that is preferred by the city since it will have the most flexibility in working out a deal with a developer. The city also has plans for a restaurant and retail/convenience type store at this site.

This site is in close proximity to the Seneca Foods facility, which discussions indicate operates 24 hours a day including truck traffic potentially at all hours, as well as being very well lighted.

This site is the closest to Gaylord and the major egg processing plant located there. It is also the most convenient to the County Fair Grounds and the Arlington Raceway, which are both located approximately one mile north of this site on County 9.

Site 2 – This site is located two blocks north of State Highway 5 behind the current location of the Technical Services for Electronics production facility in town. This is at approximately the mid-point of where State Highway 5 goes through the City of Arlington. It is currently privately owned by the founder of Technical Services for Electronics and is the logical site for expanding their production facility.

This site is the closest site to the new Arlington Community Center. Being located almost two blocks off of State Highway 5, it would have, at a minimum, somewhat limited visibility from the highway.

Site 3 – This site is located in the Industrial Park on the north/east side of Arlington as you enter Arlington from the Twin Cities on State Highway 5. This land has yet to be acquired by the city, thus requiring additional challenges and providing very limited opportunities for the city to work with the developer. Current occupants include a steel fabrication company, a new rental storage business and two farm co-ops as well as a vacant ten acre lot; all privately owned. The city has discussed possible public development in the future.

It would be the second closest to the Community Center.

The Site Analysis Chart below provides a summary look at the key factors for each site. This analysis is based upon a scale of 0 to 5, with 5 indicating a strong ranking for that factor, and 2.5 being average. The very close overall rankings for all three sites range from 2.7 – 2.8, and indicates that any one of the sites are potential sites for the proposed hotel.

<b>SITE ANALYSIS</b>			
	Site 1	Site 2	Site 3
Demand	3.0	3.0	2.5
Supply	2.5	2.5	2.5
Accessibility	3.5	2.5	3.0
Visibility	3.0	2.5	3.0
Support Services	2.5	3.0	2.5
Competitive Position	2.5	2.5	2.5
Overall Ranking	2.8	2.7	2.7
<i>Source: Smith Travel Research &amp; HMI</i>			

## ECONOMIC OVERVIEW

This section of the report provides an abbreviated overview of the economic environment in which the proposed hotel would operate. This economic analysis does not conclusively determine how successful the proposed facility will be in the Arlington market, however, it offers valuable insight into the economic stability and growth potential of the market. It will directly affect the conclusions formulated later in this report. In a more detailed Phase II Comprehensive Market Study Report, more analysis of these key factors would be presented.

The economics of this area are affected by a variety of factors within the community. Seasonality will affect what the main drivers are for the proposed hotel.

## GENERAL ECONOMIC TRENDS

- The *Population* information for Arlington was somewhat limited in availability due to its size. The current population was estimated to be between 2,300 and 2,450 people. However, for this reason, Sibley County, where Arlington is located, was reviewed.
- From 1994 to 2004, Sibley County demonstrated an average annual Population increase of 0.3% from 14,700 to 15,300. This was behind the same figures for the State of Minnesota for the same period of 1.2%. The Number of Households for the same period increased at an average annual rate of 0.5%, again behind the state annual average of 1.5%.
- *Effective Buying Income* for Sibley County increased an average of 4.1% annually from 1994 through 2004, slightly ahead of the state annual average of 3.5%. The Per Capita Effective Buying Income rates of growth are down somewhat at 3.5% for the same ten-year period, but were significantly ahead of the state figure of 2.1% for the same period. The area appears to have a good growth rate, indicating a stable employment base in the area
- *Retail Sales* activity in the Sibley County area demonstrated respectable average annual increases of 6.6% over the ten-year period 1994 through 2004. This was less than that of the State of Minnesota at 10.4% for the same time period. The average annual per capita Retail Sales growth rate for the same period was also good at 6.0%, slightly less than the same figure for the state at 8.3%.
- *Eating and Drinking Place Sales* demonstrated strong overall actual average growth rates as well. For the ten-year period of 1994 through 2004, Eating and Drinking Place Sales increased at an average annual rate of 5.8%% in Sibley County, while the similar figure for the State of Minnesota was 8.6%. For the per capita growth rate, a similar difference occurred with the State of Minnesota, being 1.5% points higher than that of the market area.

- These numbers reveal that Sibley County Retail Sales as well as Eating and Drinking Place Sales are ahead of Effective Buying Income, indicating the possible influence of outside demand sources. This is true on both an actual and a per-capita basis.

#### WORKFORCE CHARACTERISTICS

- *Workforce Characteristics* are provided for the Arlington, Minnesota market area. The leading industries from an employment standpoint are Manufacturing (27.0%), Health Education & Social Services (25.0%) and Retail Trade (13.3%). These three industries represent 65.3% of the employment in the market, and the remaining industries are small in comparison.
- Manufacturing is the largest Sector due to the two largest employers in the Arlington being Seneca Foods (on a seasonal basis) and Technical Services for Electronics. This is also supported by the location of Michael Foods in Gaylord, eight miles to the south. The Sibley Medical Center, the only hospital in the county, is a close third.

#### Unemployment Rates

- *Unemployment Rates* for Sibley County have been up and down over the past seven years, ranging from a low of 3.2% in 2000 to the current high in 2006 year-to-date of 5.5%. Since 2003, Unemployment Rates have run slightly higher than the figures for the State of Minnesota by three percentage points.

#### TRANSPORTATION

- *Transportation* to the Arlington area is via State Highway 5, which runs north/south through Sibley County as well as right through Arlington, connecting US 212 to the north and then to I-494, which encircles the Twin Cities area. In 2009, US 212 will be four lanes from I-494 to its intersection with State Highway 5, greatly enhancing the commute between Sibley County and the Twin Cities area. To the south, Highway 5 connects with State Highway 19, a main travel corridor to southwest Minnesota
- Due to the manufacturing/processing plants in Gaylord and Arlington, truck traffic is a significant component of the vehicles on State Highway 5.
- Traffic counts on State Highway 5 in Arlington increased 12.5% from 1999 to 2003. More recent counts were not available.
- The closest commercial passenger air service is provided at the Minneapolis/St. Paul International Airport, sixty minutes away. The Flying Cloud Airport in Shakopee is capable of handling small private/corporate jets and is forty-five minutes away.

## **LODGING DEMAND**

This section of the report will identify Lodging Demand sources for the proposed hotel facility. Exhibit 2 of this report identifies the primary market area that will be serviced by the subject site location for this hotel on a year-round basis.

The first area to be identified in describing the Lodging Demand Potential for the market is the *Market Segmentation* that exists in the area.

It is estimated that this market generates 80.0% of its business from Individual travel segments. Making up this 80.0%, it is estimated that 45.0% (or 56.3%) is from the Corporate/Commercial segment and 35.0% (or 43.7%) is from the Social/Leisure Market Segment. The potential of both of these projected Market Segments is dependent on the City of Arlington to grow its economic base and/or its population.

The remaining 20.0% of the Market Segmentation comes from the Group markets. Of this, it is estimated that 5.0% (or 25%) once again comes from Business-Oriented groups and 15.0% (or 75%) from Social/Leisure groups.

At this time, the subject hotel would be expected to perform similar to the area with a slight increase in the Group markets as compared to the area. Additional research will be required to determine the subject's hotel's performance based on its design and targeted Market Segmentation. Part of a Phase II comprehensive Market Study Report would include a survey of the caterers currently utilizing the Arlington Community Center to determine from them the amount of room nights generated by their business at the Center and the business that they feel is lost due to no adequate lodging facility being located in Arlington.

These numbers would need to be verified and presented in more detail in a more comprehensive market study report for a specific hotel development.

To further define the Market Segmentation of the area, preliminary profiles for each Market Segment were defined. The following outline provides *Market Segmentation Profiles* that correspond with the subject property's projected Market Segmentation.

MARKET SEGMENTATION PROFILES	
Individual Travel Markets	
Corporate/Commercial Markets	
Individual Travelers	
Vendors & Suppliers to Regional Market	
Area Companies - Major Employers	
Administrative	
Visiting doctors/medical staff	
Customers	
Service Technicians	
Training	
Social/Leisure Markets	
Area Antique Shopping	
Area Attractions/Events	
Arlington Race Track	
Polka Festival	
Golfing Packages	
Pheasants Forever Banquet/Meeting	
Visiting Friends and Relatives	
Group Markets	
Business Markets	
Area Companies	
Regional Grain/Seed conferences	
Employee meetings	
Training/Sales Groups	
Social/Leisure Related	
Social, Military, Educational, Religious, Fraternal (S.M.E.R.F.) Groups	
Weddings	
Reunions	
Displaced groups from Auburn	
Youth Sports	
<i>Source: HMI</i>	

As indicated above, this market has a variety of demand to draw from. Demand is readily identified on a limited basis in both the Social/Leisure and the Corporate/Commercial markets. Seasonality plays a part in the depth of demand for the Social/Leisure market, and to some degree, the Corporate/Commercial market.

Discussions with local officials and business leaders indicated that to a certain degree, there is business being lost to the nearby lodging facilities located in the Twin Cities market area, less than an hour's drive away, as well as the corridor on US 169 along the Minnesota River. This latter area is the location of the two closest mid-priced lodging facilities without food and beverage services, which are AmericInns, located sixteen and twenty miles away from Arlington.

Area outdoor recreation is very big during the period from May through September on weekends with weekly races at the Arlington Race Track every Saturday night. There is an estimated 1,500-1,800 fans from as far as eighty miles away in attendance every Saturday night during this time frame. Currently, fans either drive home or must go to Gaylord, nine miles away, or up to 20-25 miles for a mid-priced property without food and beverage services. Also, there are three

golf courses less than fifteen miles from Arlington. Several large lakes and the Minnesota River are within fifteen miles, providing fishing and water sport facilities.

A well equipped sports complex including both baseball and football enable the hosting of tournaments. The first of which is the 2009 Minnesota Class B Baseball tournament that Arlington will co-host over three weekends.

There is an estimated limited Corporate/Commercial market with a limited number of potential clients. These include Technical Services for Electronics, Sibley Medical Center and Seneca Foods, all located in Arlington, as well as Michael Foods in Gaylord. Discussions with Technical Services indicated that it is in the processing refinancing process and anticipates doubling its revenues from the current level of \$35 million. Its corporate headquarters is located in Arlington and long-range plans currently indicate it will remain there. It is currently utilizing lodging facilities in Gaylord and the Twin Cities and sees a need for uses ranging from national and international customers and suppliers to recruiting potential employees.

Suppliers and vendors traveling to the area are always difficult to track. However, this is a major part of the Corporate/Commercial market. Training/business seminars/conferences related to the agriculture/seed business also comprise a significant portion of potential business in this market and have been interested in hosting programs at the Community Center, but did not due to the lack of any adequate lodging in Arlington.

The Sibley Medical Center indicated that it will require rooms for visiting doctors for periods of time.

The Group Market Segment holds a variety of possibilities, and might be the Market Segment with the greatest potential growth based on utilizing the new Arlington Community Center as meeting space. In fact, this growth may possibly be greater than what was discussed earlier in the Market Segmentation breakdown. It is just five years old and contains 14,000 square feet of meeting space with two dividing walls, and is capable of seating up to 550 people at round tables. There also is a stage area, pre-function area, a full kitchen, and the city council chambers, which can be used as a board room seating up to 35. Simply put, it is the meeting space for a smaller full-service hotel, so the addition of an adequate mid-priced lodging facility would compliment it, creating a typical destination meeting/conference facility. Several organizations utilize the facility with attendees staying outside of Arlington, while a greater number of organizations have declined use of the facility, due to the lack of nearby lodging space. Also, there are the various possible reunions ranging from military to high school and others including wedding groups. Weekends are currently booked for weddings through year-end, with some being lost due to no lodging in Arlington. Currently, out-of-town guests must travel fifteen miles or more for a mid-priced lodging facility.

*Seasonality of Lodging Demand* was reviewed for the subject market area. This will provide a broad picture of the overall seasonality in the area. The following are the results of that analysis. More extensive analysis would be performed in a comprehensive market study.

- June, July and August are the strongest demand months with deviations from the average monthly demand being 124.0%, 131.5%, and 139.2%, respectively. This is to be expected due to the winter weather. This is highly seasonal, indicating either a lot going on or weak off-season demand.
- The months of May, September and October were the next strongest months with deviations from the average monthly demand being 102.0%, 110.0%, and 113.6%. This is somewhat typical because of the strength of October and May. This also indicates that winter is soft as confirmed below.
- The period from May through October is the strongest half of the year with 60.0% of the annual demand. This included three months with Occupancy greater than 61% and two greater than 54%.
- The weakest period for demand in this market is the quarter of November through January, based on the average revenue generated and on Occupancies. This period is closely followed by the three months of February, March and April.
- The market operates on a broad range for Occupancy, rates and revenue. In August, it hits the high average Occupancy of 67.3% and in December, the average low of 36.3%, which is a 31.0 point swing in Occupancy, or a 85.4% change. There appears to be less of a fluctuation in ADR, ranging from an average high of \$63.90 in February to a low of \$57.27 in November, a swing of \$6.63, or 11.6%. These two swings result in a RevPAR swing of \$19.63, or 90.3%, from an average low in December and January of \$21.75 to an average high in August of \$41.38, which indicates that the market may not be maximizing RevPAR, and thus overall revenue performance. A further review of seasonality indicated that the monthly RevPAR deviation from the annual average RevPAR exceeded both Demand and ADR deviation in the three months June, July and August; once again indicating either a high degree of seasonality in the market and/or a rather low performance in the off months.
- Saturday has the highest average Occupancy at 67.5% followed by Tuesday, Wednesday and Fridays, at 55.0% to 55.9% year-round. Sunday is the lowest night at 30.3%. Friday and Saturday nights run the highest ADR's at \$72.77 and \$75.05, respectively, while the remaining five days of the week run ADR's in a narrow range from \$56.39 to \$57.81. This also indicates that the market may not be maximizing rates and therefore, revenue performance. On a seasonal basis, the range in rates is not as great with the weekends showing a range of \$12.00 and mid-week showing a \$7.00 range in rates.

The preliminary Lodging Demand Potential for the subject property was also analyzed via the *Lodging Demand Potential Index*. This relates Lodging Demand Potential to the Market Segmentation previously projected for the subject property and the industry distribution in the area. This is a rating based on a scale of 0 to 5, with 5 indicating excellent Lodging Demand Potential and 2.5 indicating average Lodging Demand Potential. The following information shows the results of this analysis.

- It was estimated that the current Lodging Demand Potential is 2.5 or average. This could increase significantly if the proposed hotel is positioned correctly as well as a joint marketing/sales effort being utilized in conjunction with the Community Center.
- The strength in the area of the Individual travelers is split between the Social/Leisure market and the Corporate/Commercial Individual Traveler with both being ranked at 2.5, or average.
- The Group markets currently are marginal, but have been rated at average also based on the assumption that there will at least be some joint sales/marketing between the hotel and the Community Center. If this effort is done correctly and is very successful, then the Group areas would be rated above average, causing an overall above average rating. For the purposes of this report, this was not assumed since it will require a special arrangement between the city and the developer.
- This above analysis would be more defined in a comprehensive market study report.

Similar to the Lodging Demand Potential Index, a preliminary *Rate Sensitivity* analysis was also performed. This ranks the Market Segmentation planned for the proposed property and the anticipated Rate Sensitivity within the Market Segments. It utilizes a 5-point scale, with 5 indicating extreme sensitivity and 2.5 being average. The following are the results of this analysis.

- The overall Rate Sensitivity will be 2.8. The Individual Travel markets are thought to be slightly above average in Rate Sensitivity, led by the Individual Social/Leisure traveler and then the Individual Corporate/Commercial traveler. Only the Group Business market is anticipated to be average in Rate Sensitivity. Seasonality of this market will also affect these rates.
- This above analysis would be more defined in a comprehensive market study report.

*Feeder Markets* for this subject market would be generated differently by the Business and Social/Leisure markets.

- Feeder Markets for the Social/Leisure markets will be from a state/regional area with some national business for those returning for reunions and or weddings as well as

the Pheasants Forever Banquet with 700 attendees, which is the fourth largest of its kind in the United States..

- Feeder Markets for the Corporate/Commercial market will be based on where suppliers/vendors come from and will most likely be regional with some potentially being national and or international.

*Unaccommodated Lodging Demand* is described in two ways.

- The first is Lodging Demand that prefers to stay in the market area but currently uses hotels in other locations. At the present time, this type of Unaccommodated Lodging Demand occurs year-round since there are no lodging facilities in Arlington. However, if one looks at the competitive set, which was a 25-mile radius of Arlington, then this would occur during peak demand periods. A review of the Smith Travel Research *Monthly and the Day of Week Analysis* indicates that this may occur during August when the Occupancy reached a high for the competitive set of 70.3% in 2005 on a monthly basis. It also appears that this could occur on Saturdays during the months of June through October and on Fridays in July and August, when Occupancies ranged from 76.1% to 90.2%.
- The secondary definition of Unaccommodated Lodging Demand is Lodging Demand that is currently staying in the existing market area, but prefers hotel accommodations in other hotel markets. Since much of the competitive set in the Smith Travel Research report is outside of Arlington, then a similar situation as discussed above in the first paragraph occurs regarding displaced guests. Since there are no lodging facilities in Arlington, this is not a factor here.

## **LODGING SUPPLY**

This section of the report describes the primary competitive Lodging Supply that will affect the subject property, particularly for hotel room demand usage.

In the immediate Arlington area, as stated earlier in this report, the sole lodging facility is a 10-room motel which the owner rents out on a monthly basis to the employees of his construction business. Therefore, when reviewing the Lodging Supply, a broader area was considered in a radius of twenty-eight miles of Arlington to arrive at a competitive set which reports data to Smith Travel Research. There were twenty-four lodging facilities found to be in this competitive set, totaling 996 rooms.

- The primary competitive set for the proposed property will be those properties considered to be limited-service mid-priced without food and beverage services. There were four properties averaging 57 rooms considered to fit this category, all AmericInns, and from 15.6 to 25.5 miles from Arlington.
- There were five Economy properties, all Super 8 Hotels, from 11.5 to 28 miles from Arlington, with an average size of 36 rooms.
- There are eleven independent lower to middle type properties, from 8 to 28 miles from Arlington, with an average size of 33 rooms. This category includes the Gold Leaf Inn & Suites in Gaylord, which is the closest hotel to Arlington, at eight miles away.
- The balance of the hotels include two mid-priced with food and beverage, both being located 28 miles from Arlington.

A Phase II comprehensive market report would break down these hotels in more detail. Also, some of these hotels may be eliminated as primary competitive hotels to the proposed hotel in Arlington.

It appears that the hotel products serving this market are heavily oriented to the Economy/Independent lower end hotel category. These hotels are not well positioned to serve both the Rate Sensitivity of the market and the diversity of the Lodging Demand researched. The majority of the properties only address the Rate Sensitivity issue but do not address the other needs of the market, thus causing those travelers seeking more than an Economy property to go fifteen or more miles away, or even to the Twin Cities area. Only a few of the competitive properties are capable of moving their rates effectively to meet higher demand periods. This was evidenced by the relatively narrow range of the average monthly ADR discussed earlier in this report.

A preliminary comprehensive rate analysis was performed for this report. More comprehensive data would be presented as part of a Phase II Comprehensive Market Study. However, a

preliminary review of room rates and the resulting ADR's for the primary competitive properties indicated that there are two tiers of rates in the market.

In reviewing the rate structure in the market, the following preliminary observations were noted.

- The first rate tier is in the \$53 to \$55 range. This was represented at the Super 8 lodging facilities.
- The second rate tier is in the \$72 to \$74 range. This was seen at the Best Western Chaska River and the Holiday Inn New Ulm, both of which provide food and beverage service.

This would indicate that there is room for a suggested rate tier, somewhere in the middle in the \$60 to \$65 rate range. This happens to be where the Microtel Inn in New Ulm, which is thirty miles from Arlington, is believed to be operating in.

Over the past four-and-a-half years, the average rate for this competitive set/regional market is in the range of \$60. Year-to-Date through May in 2006, the ADR is \$63.01 vs. \$61.32 for the same period the prior year.

A more complete rate analysis would be performed in a more comprehensive market study. However, based upon a preliminary review of the rates in this market area, the potential appears to exist for a new mid-priced hotel without food and beverage services, which would need to be positioned in the \$65 range. Assuming an opening in Spring 2008, and applying a 3% inflation rate for two years to the market average ADR for 2006, this would position the hotel in the middle of the competitive set's inflation adjusted ADR of \$68 to \$70. This would be positioning the proposed hotel slightly below the properties with food and beverage facilities, but above the Economy level properties.

A comprehensive *Competitive Factor Analysis* was not completed at this time. This would be part of a more comprehensive market study report. However, the preliminary analysis indicates that the existing hotels would be competitive with the proposed hotel.

- The *Location* of the hotel will be competitive to serve the growing Arlington market area. Two of the three suggested locations are right on State Highway 5, providing the proposed hotel with excellent visibility. One site, # 2, gives the best location as far as its proximity to the Community Center, but the other two are each within a mile of the Community Center and will still work well.
- The *Age* of the competitive hotels will be a competitive factor for the proposed hotel. The average age for the competitive set hotels is 14.5 years. Four of the properties in the competitive set are fourteen years old or more old. The newest property, the Microtel in New Ulm, is thirty miles away, which negates any age advantage it might have in competing with the proposed property.

- There is limited *Brand* representation in the market area in general with only five brands in total in all Markets Segments: Super 8, Microtel Inns, AmericInns, Best Western and Holiday Inns. Only one of these is a limited-service mid-priced without food and beverage brand – the AmericInn. Major hotel brands are better represented in Mankato, thirty miles to the south, or the Twin Cities areas of Shakopee, Chanhassen and Eden Prairie.
- The *Facilities* of the competitive hotels are all similar. The proposed property will have two distinct advantages over the majority of the competitive hotels located within the twenty-five mile radius mentioned earlier. First, it will be in close proximity to and will be selling with and/or in coordination with the Community Center, providing it with meeting/banquet space. All other properties except two do not have this option. Secondly, it should be providing greater and better service than over half of the properties within this radius because of its design as a mid-priced limited-service hotel. Also, the age and condition of the competitive properties will also be a factor.

#### COMPETITIVE LODGING PERFORMANCE

*Competitive Lodging Performance* figures for this area look at the recent performance of the market and the primary competitive hotels. A more comprehensive presentation of lodging operational data and analysis would be included in a more comprehensive report.

- Lodging Demand has averaged an annual increase of 2.4% per year since 2002. However, during 2004, the demand declined (-4.9%). Year-to-date through May, the demand for the competitive set increased 4.2% in 2006 versus a decline of (-0.1%) for the same period the prior year. This would indicate that a significant increase in demand in 2006 over 2005, if the pattern holds through the end of the year.
- Lodging Supply has not increased during the years covered from June, 2002 through May, 2006.
- Smith Travel Research reported the performance of the market showing Occupancy ranging from 47.6% in 2002 to 50.9% in 2005. Year-to-date Occupancy in 2006 is at 44.3%, compared to 42.5% last year, showing a slight increase. The average Occupancy over the prior four years was 49.2%, which would be below the potential performance of the proposed hotel of 56% to 60% for an opening year in 2008. This higher than average Occupancy is due to the proposed subject hotel having access to meeting space and being mid-priced for this Phase I Market Study.
- The performance of the market shows Average Daily Room Rates ranging from \$57.20 in 2003 to \$62.36 in 2005. The average annual rate for the four-year period is \$60.12. The average annual increase of the ADR for the four-year period was 1.0%. This low rate is mainly due to a (-5.7%) drop in 2003. In 2006, the ADR is up

2.8% through May, compared to 4.2% for the same period in 2005, indicating a potential increase in ADR in 2006 of 2.3%. It would be expected that the proposed hotel will perform above the market's level of ADR, once again due to it being a mid-priced limited-service property, while most of the competitive set are Economy-type properties.

The performance of the market shows Revenue Per Available Room (RevPAR) ranging from \$28.86 in 2003 to \$31.77 in 2005. The RevPAR had a significant increase in 2005 (9.8%) and shows year-to-date in 2006 an increased 7.1%, versus an increase of 4.2% for the same period the prior year. This indicates another strong increase in RevPAR again in 2006, of potentially 16%.

#### PROPOSED PROPERTIES

There are no known proposed hotel properties in the Arlington market area.

## **ISSUES AND RISKS**

The following section of the report deals with topics that should be addressed when developing a hotel project such as the one studied in this report. Many of these topics are common to hotel development and are addressed here as a matter of due diligence in evaluating the subject market and subject site for the proposed hotel. Also highlighted in this section are any concerns which have arisen during the research portion of this report that would directly affect the hotel development. This may require additional research by the developer when pursuing the development of the property. A more comprehensive market study would expand these topic areas as needed.

- Regarding *Competitive Pricing Pressures*, this market and the subject hotel will need to be sensitive to the pricing strategies established in current lodging markets and the nature of the Market Segmentation forecasted. This market has the potential to be Rate Sensitive in both the Social/Leisure and Corporate/Commercial markets. Therefore, proper selection of the type of hotel will be critical to establish the proper price positioning.
- It is recommended that the type of hotel has the capability of increasing rates during peak demand periods and the ability to offer solid price/value at lower rates during slower demand periods. A well positioned, Mid-Priced to Upper-Mid Priced limited-service hotel type would be recommended to provide this positioning in the market. This will give it a greater rate range in stronger months. A new hotel would have some advantages over existing hotels. New facilities and amenities, such as some limited meeting space or a board room, an indoor pool with a "special feature" or two, a few suites/honeymoon suites, as well as being designed to present almost a bed & breakfast feel, would set it apart from the competition.
- *Growth in New Lodging Supply* does not appear to be an imminent problem.
- *Growth in Lodging Demand* appears to be strong based on performance year-to-date this year. Continued annual increases in Lodging Demand could be negatively impacted if and when there is addition to the Lodging Supply. The continued growth of the Twin Cities towards this area should ensure the growth of Arlington both economically and from a population standpoint. This will in turn continue the growth in demand. The improvements to US 212 to be completed in 2009 will also contribute continued demand growth. Most of this demand will be transient and is difficult to track.
- A detailed analysis of the *Property Tax* structure in the Arlington area was not conducted within the scope of this report. The developer should analyze the property tax structure within the Arlington area
- The *Political Climate* in the market was reported to be supportive of hotel development. Discussions with local officials indicated a willingness on their part to

work with a developer regarding certain incentives, in order to encourage that the hotel is developed in Arlington.

- No unusual *Environmental Concerns* were noted in the area. The subject sites are located close to developed land in the area. The city has not experienced any problems with other developments in this area. A detailed Environmental Impact study was not within the scope of this report.
- All of the subject sites would need minimal improvements regarding utilities including electric, telephone, gas, water, and sewer, since these are already located in the immediate area of the subject sites. Grading of the sites would be minimal. The subject sites do not appear to be in a flood plain area nor do they appear to be experiencing any water drainage or seepage problems. Toxic waste issues were not directly addressed within the scope of this study. Wetland issues were also not addressed, but these areas were not felt to be in effect at the subject sites. The developer should conduct the necessary environmental impact testing to make sure the subject sites are within compliance with local ordinances and environmental regulations for the area.
- The *Labor Market* was reported as being adequate in the area to support hotel development. No *Wage Pressures* were reported that would affect hotel operations. Wage scales would need to be competitive with other employers in the Service and Retail sectors and markets in the regional market area.
- An *Area of Franchise Protection* is advisable to ensure that there is no encroachment by a similar brand property on the market area. This will require negotiating with the proposed franchise brand to ensure adequate protection. Areas of Franchise Protection should be established to cover the primary market area identified in Exhibit 3 of this report.

## CONCLUSIONS

The following *Conclusions* are based upon the analysis of the research performed for this market study in relationship to the construction of the hotel project at the subject site. These conclusions will project preliminary operational performance for the subject hotel. These projections are based upon present operating performance of the market at the time of this report. At this time, preliminary projected growth in Lodging Demand or growth in ADR was factored into these preliminary projections. These projections will tentatively demonstrate how the property would perform in the market at the present time.

A more comprehensive market study would project performance to a more stabilized market level for the subject hotel by the third year of operation. These projections need to be fine-tuned and modified in a more comprehensive report for a specific hotel development and would help to determine the actual improvement of operational performance to a stabilized year of operation. Stabilization typically occurs within three years of opening the property, however, a more comprehensive report would address whether this would occur more quickly in this market.

These projection elements would also be modified according to any specific changes in the development plan upon reviewing this report, and these changes would be factored into a more comprehensive market study when required. These preliminary projections are provided for the consideration of the developer in determining the size of the property to be developed at the subject site. Effects of Occupancy, Revenue, and Maximum Allowable Development Costs will be reported accordingly.

## PROPERTY RECOMMENDATIONS

The following *Property Recommendations* were based upon the research conducted for this report.

### Property Type

Based upon the projected Occupancy and Average Daily Room Rates in the area and the product segmentation for both lodging and hotel supply segmentation, it appears that the *Property Type* should be positioned in the Mid-Priced limited-service without food and beverage hotel product category. This would allow the hotel to adjust rates to meet regional Lodging Demand markets in stronger demand periods. It would also allow for the hotel to adjust rates with regional hotel properties in weaker demand periods. This will be critical in a market area such as this. Reviewing the demand characteristics identified for this market, this type of hotel product position seems appropriate to consider. As a result, product positioning and rate would become a marketing advantage for the property in maximizing revenue and attracting demand.

### Property Size

The recommended *Property Size* will depend upon a developer's decision to proceed to develop the proposed hotel project. Projections for a 55-room property were contained in this report. It is suggested that the property be initially developed with a size that would be compatible with the overall market. The average size of all lodging properties in the competitive set was 70 rooms, while the average size of the hotels in the total market area (a 30-mile radius) is 43 rooms. It is felt that, based upon the research analyzed at this time that a 55-room hotel with the potential for

expansion would be in line with the Lodging Demand research developed for this market. Developing a larger property would not be advised at this time, as there would be more operational challenges the hotel would have during slower demand periods. Until the market has demonstrated its ability to absorb the new hotel rooms planned with increases in Lodging Demand, developing a larger property is not advised. If the smallest sized property that can be affiliated with a national brand indicates a larger size, then increasing the room count should be considered, but not to exceed 65 to 70 rooms.

#### Property Amenities

Recommended *Property Amenities* should be compatible with the product type and the brand affiliation selected for the property. Also, consideration must be made to the Market Segmentation Profiles and demographics of the market. Product offerings should be in line with any national chain franchise that would be selected for the property.

Additional property amenities and services that may be required are as follows:

- At the subject site location, bus and recreational vehicle parking areas for trailers and motor homes should be available. This will allow for overnight tour groups and families with campers.
- An indoor swimming pool that includes a “small enhanced water amenity type feature” should be included. This type of amenity would assist in servicing the Social/Leisure markets and specifically family tourists, weddings and reunions traveling to this area.
- Offering a public whirlpool and/or a sauna in the swimming pool area is also suggested. Having two to four whirlpool suites and/or “honeymoon suites” could also be considered to attract Social/Leisure travelers and assist in the sale to wedding groups at the Community Center.
- Having a small meeting/hospitality room could be considered. This facility could generate some sleeping rooms from area business markets. The wedding and reunion markets could use this type of facility for hospitality gatherings. However, it should be sized so that it does not compete with the facilities in the Community Center.
- If design/layout of the facility permits, the complimentary breakfast area should be off the pool area with easy/direct access, permitting this room to be utilized as a party room for area resident birthday parties that are utilizing the pool as well.
- The ability to provide transportation upon request to area attractions and/or events including the Arlington Race Track, local companies, and Sibley Medical Center, would be a plus but not a necessity since most travelers will be arriving via their own vehicle anyway.

### Sleeping Room Configuration

The recommended *Sleeping Room Configuration* should be compatible with the overall Market Segmentation for the area for this property. Given the fact that the property will have a high amount of Social/Leisure travelers, double queen-bedded configurations in the sleeping rooms may be the preferred room type. This will also provide greater flexibility for groups. The balance of the rooms should be king-bedded rooms with sleeper sofas for Social/Leisure and family traveler use. Having some suites, including whirlpool suites (maximum of ten percent), would be suggested. A limited number of suites, such as one or two, could be configured as extended-stay suites with microwaves and refrigerators.

It is recommended that all guest rooms be designed in size to be between 350 and 400 square feet, which is larger than the typical hotel room, in order to provide a sitting/lounging area with its own television.

### Brand Affiliation

Regarding *Brand Affiliation*, it would be recommended that a national brand or strong regional brand be selected for the hotel. This would help attract travelers to the area with a national brand recognition they are familiar with. An independent operation of this hotel would not be recommended at this time.

Possible brand affiliations that could be reviewed are as follows. The list is not limited to these and could be expanded accordingly. They are also not presented in order of importance.

- Country Inn & Suites - Radisson Hotels (Upper Mid-Priced)
- Comfort Inn & Suites - Choice Hotels
- Sleep Inn – Choice Hotels
- Fairfield Inn & Suites - Marriott
- Hampton Inn “Hometown” - Hilton Hotels (Upper Mid-Priced)
- Holiday Inn Express - Intercontinental Hotels
- AmericInns
- LaQuinta Inns

Of the above list, the strongest brands would be Fairfield and Hampton. However, due to the size of the proposed property, this could be an issue with these two brands as being too small. Country Inn & Suites could be a very good fit for this location due to its very strong regional presence and reputation.

Areas of Franchise Protection should also be addressed when choosing brand affiliation. The Areas of Franchise Protection were highlighted in the *Issues and Risks* section of this report.

### Room Rate Strategy

The recommended *Room Rate Strategy* for this property should be compatible with the attainment of the Average Daily Room Rate projections indicated in this report. Seasonality of Room Rates will also need to be a consideration at this property. Given the Average Daily Room Rate research performed and projections established in this report, it appears that this property could compete with the hotels in the overall annual \$64.00 to \$70.00 ADR range. During slower demand periods, the hotel will need rate flexibility to attract demand. Analysis of competitive room rate structures needs to be performed in establishing room rates that will obtain the Average Daily Room Rates projected in this report. This would be part of a more comprehensive market study for this hotel.

#### Opening Date

A recommended *Opening Date*, based upon the Seasonality of Lodging Demand, would indicate that a formal opening in April would be recommended. This would correlate with the improvement of Lodging Demand in the market on a seasonal basis and the opportunity to maximize revenue prior to entering the softer off-season months beginning in December.

### PROJECTED PROPERTY PERFORMANCE

#### 55-Room Property

The following chart will show the preliminary projected property performance for a 55-room hotel developed at the proposed subject site in the stabilized year, which is typically the third full year of operations; in this case 2011. Specifically, Occupancy, Average Daily Room Rates, and Projected Revenue are presented. These projections factored in the new 55 rooms from this hotel. Also, these projections are based upon the current average performance of the market and the proposed property receiving its fair share of that business. Rates of growth for demand and supply were not factored in. These would be factored in when a more specific hotel development is considered in a Phase II Comprehensive Market Study. More detailed projections for the first three years of operation would also be provided in a Phase II Comprehensive Market Study.

<b>PROJECTED PERFORMANCE - 55 ROOM HIE HOTEL</b>			
	<b>PROJECTED MARKET PERFORMANCE <i>PRESENT MARKET</i></b>	<b>PROJECTED MARKET PENETRATION</b>	<b>PROJECTED PERFORMANCE 55 Rooms</b>
<b>OCCUPANCY</b>			
2011	55.2%	108.7%	60%
<b>ADR</b>			
2011	\$72.32	104.3%	\$75.40
<b>RevPAR</b>			
2011	\$39.92	113.3%	\$45.24
<b>REVENUE</b>			
2011	\$6,134,725	N/A	\$908,171
<i>*Projected performance is +/- 5 percentage points and will be affected by changes in Lodging Supply and Demand growth levels used to formulate these projections.</i>			
<i>Source: HMI</i>			

The figures presented in the chart above represent how the proposed property will most likely perform. More detailed information including potential high and low estimates of how the proposed property might perform would be included in a more detailed Phase II Report. It is expected that the hotel would perform well in this market ranging from slightly below the market to meeting or slightly exceeding the market.

It is felt that a portion of the strength of the proposed property's performance will be the ability to sell and work with the Community Center in Arlington to the point that it appears to the potential guest that these facilities are one entity.. Also, the continued growth of the Arlington area and its demand generators will also be a factor in the strength of the proposed hotel's performance.

#### MAXIMUM ALLOWABLE DEVELOPMENT COSTS

The benchmark calculation, based upon Occupancy and Average Daily Room Rate projections, was established for Maximum Allowable Development Costs. This provides a preliminary indication of the viability of developing this hotel project based upon these Occupancy and Average Daily Room Rate projections. More comprehensive feasibility research should be performed regarding anticipated operational expenses and fixed cost structuring such as debt service, property taxes, insurance, and depreciation, to formulate a more thorough analysis of the financial viability of this hotel project. The land cost will also be another factor that will have significant impact on Maximum Allowable Development Costs.

Maximum Allowable Development Costs take into account all costs associated with the hotel's development up to its stabilized year of operation. This includes: land costs; land preparation costs; development costs; construction costs; furniture, fixtures and equipment (FF&E); pre-opening operational and marketing expenses; and cash flow shortages to a stabilized year of operation. Any other associated development costs would also be part of this calculation. A

developmental Occupancy factor of 60.0% for a Mid-Priced to Upper-Mid-Priced, limited-service hotel without food and beverage operations was utilized in this calculation.

A development cost factor of \$1.40 of Average Daily Room Rate per thousand dollars of development cost was utilized for a Upper-Mid-Priced type hotel without food and beverage operations. Deviations from the developmental Occupancy factor were calculated based upon Occupancy projections established in this report. Also, a rate of 3% was applied on an annual basis when arriving at the ADR. Using this calculation, the following preliminary benchmark Maximum Allowable Development Costs were established.

<b>MAXIMUM ALLOWABLE DEVELOPMENT COSTS</b>		
	ALLOWABLE PER ROOM*	ALLOWABLE TOTAL PROJECT COST*
<b>55 Room</b>	<b>\$49,287</b>	<b>\$2,710,780</b>
<i>*These projections will be affected by changes in Projected Occupancy or Projected ADR.</i>		
<i>Source: HMI</i>		

Ideally, as the developer calculates development costs for this property, the total development costs should not exceed this preliminary benchmark, break-even Maximum Allowable Development Costs. Exceeding these Maximum Allowable Development Costs may indicate that the property is not financially feasible to pursue. However, projected development costs below these benchmark Maximum Allowable Development Costs may indicate that additional research should be performed by the developer to determine the overall economic feasibility of developing this hotel property.

A more detailed analysis which would address future values of development costs and return levels based on equity investments would be addressed in greater detail in a Phase II Market Study.



## DISCLAIMER

The decisions presented herein were based upon the information available and received at the time this report was compiled. Hospitality Marketers International Inc. (HMI) has taken every possible precaution to evaluate this information for its completeness, accuracy and reliability. To the best of its knowledge, HMI feels the information and decisions presented herein are sound and reliable.

It must be noted that on September 11, 2001, the United States was attacked by terrorists. The results of that attack had significant effects on the economy and social attitudes of the United States. These attacks also significantly altered normal travel patterns by various market segments generating potential lodging demand. At the time of the writing of this report, the United States travel industry, and specifically the hotel industry, are still recovering from these events, and the actual long-term results of these events are still uncertain. There are expectations that the United States will ultimately recover from these events and their affects on the economy and society, however, there are further expectations that some travel patterns will be changed indefinitely. This report will look at historical trends prior to these significant events. Performance since September 11th to the time of this report will also be reviewed and will attempt to factor the effects of these events into the future projections and conclusions presented in this report. Given the present state of uncertainty, HMI is not responsible for affects that occur from future political, economic or social events that ultimately alter these projections.

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Also, it should be understood that normal economic and marketplace conditions change constantly. HMI assumes no responsibility for information that becomes outdated once this report is written; nor is it responsible for keeping this information current after July, 2006.

It should be understood that the results presented in this report are the professional opinion of HMI and are based upon the information available at this time. These opinions infer proper and professional management of the business operation. The opinions also infer that market conditions do not change the information received upon which these opinions have been based. HMI assumes no responsibility for changes in the marketplace.

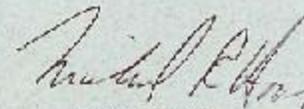
Furthermore, it is presumed that those reading this report completely understand its contents and recommendations. If the reader is unclear of the understanding of the contents, clarification should be received from its writer, HMI.

Lastly, HMI assumes that those who receive this study act in accordance with its recommendations. Any deviation from these recommendations is solely the responsibility of those receiving this report.

Further questions concerning this report should be directed to HMI.

Sincerely,  
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