



HOTEL FEASIBILITY STUDY

WASECA, MINNESOTA

April 2017

Prepared for:

City of Waseca



Mr. Gary Sandholm
Economic Development Coordinator
City of Waseca
508 South State Street
Waseca, MN 56093

Dear Mr. Sandholm:

The Hospitality Consulting Group is pleased to present the accompanying report entitled: "Hotel Feasibility Study–Waseca, Minnesota" which has been prepared in accordance with our engagement letter dated September 13, 2016.

Incorporated within this report are discussions of the local and area market conditions, characteristics of competitive hotels, analysis of the potential lodging demand available to a new hotel, recommendation of hotel facilities, estimates of hotel utilization, and financial projections for the hotel's first five years of operation.

Our conclusions are based on information developed from research of the market, discussions with local government officials, representatives of the business community, and on our knowledge of the industry. The sources of information and bases of the estimates and assumptions are stated in the body of the report. Some assumptions inevitably will not materialize and unanticipated events and circumstances may occur; therefore, actual results achieved during the period covered by our analysis will vary from our projections and the variations may be material.

Further, we are not responsible for future marketing efforts and other management actions upon which actual results will depend.

We have no responsibility to update this report for events and circumstances that occur after the conclusion of our field work, which is concurrent with the report date shown below. However, we are available to discuss the necessity for revision in view of changes in the economic and market factors affecting the project.

Our report is intended solely for the City of Waseca's information for use in developing a hotel. It may also be used to obtain funding for the hotel. Otherwise, neither the report nor its contents, nor any reference to our Firm may be referred to or quoted in any registration statement, sales brochure, prospectus, loan, appraisal or other agreement or document without our prior written consent.

April 3, 2017

Hospitality Consulting Group, Inc.

HOSPITALITY CONSULTING GROUP, INC.

HOTEL FEASIBILITY STUDY WASECA, MINNESOTA

Letter of Transmittal

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SECTION 1: INTRODUCTION

BACKGROUND

Waseca, Minnesota is a stable community located in the south central part of the state. The city's hotel stock is aging and has only one nationally franchised property. As a result, it is losing lodging demand to newer hotels in the neighboring communities of Mankato and Owatonna. Having recognized this situation the City of Waseca is interested in attracting a new hotel to the community.

Hospitality Advisors has extensive experience working with hotel developments throughout the United States. We were retained to research the market support for a new hotel and to recommend the scope of facilities that can be market supported, develop estimates of utilization and prepare projections of the hotel's room revenues and operating results. The scope of our work in conjunction with this engagement is summarized below.

SCOPE OF WORK

Our research into the market support for a new hotel included the following:

- Determination of the primary market area and evaluation of pertinent demographic and economic information;
- Identification and evaluation of competitive lodging facilities;
- Interviews with local employers regarding their hotel needs;
- Identification of likely sources of lodging demand;
- Review of area meeting space and event centers;

- Projection of the lodging demand that a new hotel in Waseca could reasonably expect to capture;
- Development of facilities recommendations for a new hotel;
- Projection of the average daily rate and levels of utilization a new hotel could expect to achieve in its first five years of operation;
- Preparation of financial projections for the recommended hotel's first five years of operation; and
- Preparation of this final report documenting our findings, conclusions, recommendations, and financial projections for the hotel.

SECTION 2: EXECUTIVE SUMMARY

This section describes, in brief, the findings and conclusions derived from our study of the market for a new hotel in Waseca, Minnesota. This overview includes our review of the market area, the competitive environment, the recommended facilities, and financial projections for the hotel's operations. The estimates and the information presented in this section are meant as a summary of, not a substitute for, the body of the report which contains additional information and detail critical to a full understanding of the basis for the estimates made and the context within which they were formed.

Project Description

Waseca's hotel stock is aging and as a result, it is losing lodging demand to neighboring communities. Having recognized this situation the City of Waseca is interested in attracting a new hotel to the community.

Site Review

A bypass for U.S. Highway 14 around Waseca was completed in 2012 with two interchanges: a southern access at State Street and a western access at 360th Avenue. We believe that the best location for a new hotel will be at one of these interchanges to allow for capture of highway traffic. Since there is no commercial activity at either interchange, we believe that a new hotel should be accompanied by at least a fuel station/convenience store. Such a development will help to stop traffic and reduce the impression of isolation by creating more lights and activity.

The southern interchange is closest to downtown and supporting amenities, however, there is very little developable land available. There is developable land in all four quadrants of the western interchange, however it is more distant from downtown and lacks any commercial development.

Local Market Conditions

The City of Waseca is located near the center of Waseca County in south central

Minnesota. It is located approximately 15 miles west of Owatonna and 30 miles east of Mankato.

Waseca's population increased by 11 percent between 2000 and 2010 and presently has around 9,400 residents. Waseca County, with a population of 19,100, lost 2 percent of its population over the decade. The county is expected to reverse the trend of population loss that occurred between 2000 and 2010 and increase by nearly 4 percent over the next 10 years.

The local economy benefits from a large manufacturing component and a number of strong companies operate plants in the community. Waseca also benefits from a federal prison and a community hospital and clinic. The county's unemployment rate of 4.4 percent is below the national level but above the state rate.

Hotel Supply

The proposed hotel would compete with one of the two existing hotels in Waseca, and would recapture demand that presently stays in upper midscale hotels in Mankato and Owatonna.

Waseca Lodging Supply

There are two lodging properties in Waseca with a total of 88 guest rooms. Only one of these hotels, the 37-room Crossings by GrandStay, would be considered to be directly competitive with a new hotel. It is a 20-year-old midscale hotel that can no longer meet the needs of many of the community's commercial and leisure travelers. Two hotels in Mankato, the 88-room Holiday Inn Express & Suites and the 61-room Fairfield Inn & Suites, would also be competitive as they capture some Waseca lodging demand. We also identified one hotel in Owatonna, the 130-room Holiday Inn & Suites, that receives lodging business from Waseca.

Hotel Demand

In 2014 and 2015 the hotel industry achieved its highest level of occupancy in the last 25 years and the industry is expected to maintain a 65 percent occupancy over the next few years. The increase in room rates is expected to slow somewhat, but should still achieve a 4 percent annual growth.

A new hotel would capture lodging demand from business activities in and around Waseca, through travelers on U.S. Highway 14, visitors to area residents, visitors drawn by athletic tournaments, and community events.

Due to the proximity of Owatonna and Mankato, Waseca's primary market area is defined by the area within about a 10-minute drivetime. A new upper midscale hotel in Waseca would capture local commercial, group, and leisure demand that are leaving the market now due to the lack of new hotel facilities. In order to quantify the amount of lodging demand that exists in the community, we obtained lodging tax data to evaluate recent trends regarding both the levels of demand and seasonality that is accommodated by the existing competitive hotels. In addition, we contacted area companies to gain insight into their lodging needs and to identify the hotels they utilize. Based on our market research and data available to us, we have estimated the amount of demand that is accommodated by the two local hotels and the three hotels in neighboring communities that are judged to be competitive with a new hotel in Waseca.

The two competitive hotels in Waseca, with a total of 88 guest rooms, are estimated to have experienced around 10,000 occupied roomnights in 2016. Our interviews with local companies found that a large portion of lodging demand leaves the market in search of higher quality hotel facilities. Based on our observations, research and analysis, we believe the current hotel supply to be somewhat obsolete and insufficient to meet a large portion of the community's lodging needs.

Accordingly, we estimate that a new hotel of upper midscale quality with a strong franchise could retain approximately 4,200 annual roomnights that are now leaving the Waseca market.

In addition, we estimate that a new hotel could attract approximately 2,400 new roomnights to the market arising from business off of the highway and new leisure and group business hosted due to the availability of high quality hotel facilities.

We have assumed an annual 1.0 percent growth in the area's base lodging demand. The projected market growth is summarized below.

**PROJECTED LODGING DEMAND
Competitive Waseca Market**

<u>Year</u>	<u>Available Rooms</u>	<u>Demand (Roomnights)</u>	<u>Annual Growth</u>
2016	32,120	9,986	
2017	32,120	10,086	1.0%
2018	32,120	10,187	1.0%
2019(1)	50,370	16,271	59.7%
2020	50,370	16,904	3.9%
2021	50,370	17,276	2.2%
2022	50,370	17,449	1.0%
2023	50,370	17,624	1.0%

Note 1: Assumes 50-room hotel opens

Recommended Facilities

Based on our evaluation of the local hotel supply and demand conditions we believe that an upper midscale hotel with approximately 50 rooms carrying a well-recognized national franchise should be considered for Waseca. The hotel should provide a breakfast free of charge to hotel guests and other amenities should include an indoor pool, a room with fitness equipment, high speed wireless internet access, a business center, and a guest laundry. Three or four 1-bedroom suites should be included in the hotel's room mix; at least one should have kitchen facilities. Also, a small meeting room of approximately 500 square feet should be considered to accommodate small business meetings and social events.

Projected Occupancy

By calculating the ratio of the rooms available at the subject hotel to the total number of rooms available within the competitive market, the "fair share" percentage of demand for the hotel may be determined. The fair share calculation reflects the market share that the hotel could expect to capture if all available competitive rooms in the market were favored equally by potential guests and choices were made on a purely random basis.

Based on the results of our market study, we estimate that the subject hotel would be able to capture 111 percent of its fair share of the demand currently being accommodated at the two local hotels.

In addition, we believe that the new hotel could recapture much of the demand that is leaving the market to stay in hotels located in neighboring communities. It will also attract some demand from through travelers on Highway 14 and will stimulate new leisure and group demand. We have calculated this recaptured and new demand to be 65 percent of the total demand that is currently being captured by the two local hotels.

The size and segmentation of the lodging demand available to the new hotel is summarized in the following table.

Estimated Potential Waseca Hotel Demand (2016)

Market Segment	Total	Commercial	Leisure	Group
Two Competitive Hotels	10,000	4,800	4,700	500
Recapture Demand Leaving Market	4,200	2,400	1,600	200
New Business	2,400	600	1,400	400
Totals	16,600	7,800	7,700	1,100
Percent of Total	100%	47%	46%	7%

The results of our utilization analysis are presented in the following table, which show the subject hotel achieving projected annual occupancies that range from 53 percent in its first year to 61 percent in its fifth year.

RECOMMENDED HOTEL
Projected Market Mix and Occupancy
50 Rooms

Market Segment	2019	2020	2021	2022	2023
Commercial	4,200	4,500	4,700	4,800	4,800
Leisure Travelers	4,900	5,300	5,500	5,600	5,700
Group	600	700	700	700	700
Totals	9,700	10,500	10,900	11,100	11,200
Annual Occupancy	53%	58%	60%	61%	61%

Occupancies projected for the first two years are lower than the stabilized level of operation, as the hotel will require time to develop its marketing program, particularly for group business, and to maximize public awareness of the hotel facilities.

Average Daily Room Rate

The analysis from which we developed our projections of average daily rate for the subject hotel included the quality and pricing structure of the other competitive hotels. The average daily rate last year at these hotels was estimated to range between \$85 and \$130. Based on our analysis, we have determined that the subject hotel should be able to achieve an average rate of \$105 expressed in 2016 dollars.

Factored into the room rates projected for the subject hotel are an inflation factor of 2 percent and a real growth factor of 1 percent, for a total increase of 3 percent annually. The inflated average rate in 2019, its first full year of operation, is projected to be \$114.74, increasing to \$129.14 by its fifth year of operation.

Financial Projection Summary

Our financial projections prepared for the first five full years of operations for the recommended hotel are summarized in the following table.

FINANCIAL PROJECTION SUMMARY 50-ROOM UPPER MIDSCALE HOTEL

	2019	2020	2021	2022	2023
Occupancy	53%	58%	60%	61%	61%
Average Daily Rate	\$114.74	\$118.18	\$121.72	\$125.38	\$129.14
Total Revenue	\$1,129,524	\$1,259,152	\$1,346,137	\$1,411,762	\$1,467,013
Departmental Expenses	(251,294)	(271,474)	(286,795)	(297,564)	(306,080)
Undistributed Expenses	(282,269)	(318,741)	(348,911)	(362,314)	(373,754)
Fixed Charges	(176,015)	(244,159)	(269,642)	(280,019)	(289,107)
Cash Flow For Debt Service	\$419,947	\$424,778	\$440,790	\$471,864	\$498,071

Economic Feasibility Analysis

For purposes of analysis, Hospitality Consulting Group assumed the hotel to have a total cost of \$5,800,000, or approximately \$116,000 per guest room. This includes a site cost assumed to be \$10,000 per room or \$500,000. The budget does not include any costs associated with extending municipal utilities to the site.

The financing terms utilized in the analysis assumed an equity investment of \$1,450,000, leaving a loan of \$4,350,000 to provide funds for the \$5,800,000 total project cost.

Source of Funds:

Equity	\$1,450,000	25%
Debt	<u>4,350,000</u>	<u>75%</u>
	\$5,800,000	100%

Debt Term Assumptions:

Annual Interest Rate:	5.00%
Amortization:	20 years
Annual Payment:	\$344,497

The results of the feasibility analysis are presented in the following table.

**Proposed Hotel-Waseca, MN
Economic Feasibility Analysis
Project Cost: \$5,800,000**

	2019	2020	2021	2022	2023
Cash Flow Available for Debt Service	\$419,947	\$424,778	\$440,790	\$471,864	\$498,071
Debt Service	\$344,497	\$344,497	\$344,497	\$344,497	\$344,497
Debt Service Coverage	1.22X	1.23X	1.28X	1.37X	1.45X
Cash Flow to equity	\$75,450	\$80,282	\$96,293	\$127,367	\$153,574
Equity	\$1,450,000	\$1,450,000	\$1,450,000	\$1,450,000	\$1,450,000
Return on Equity	5.2%	5.5%	6.6%	8.8%	10.6%

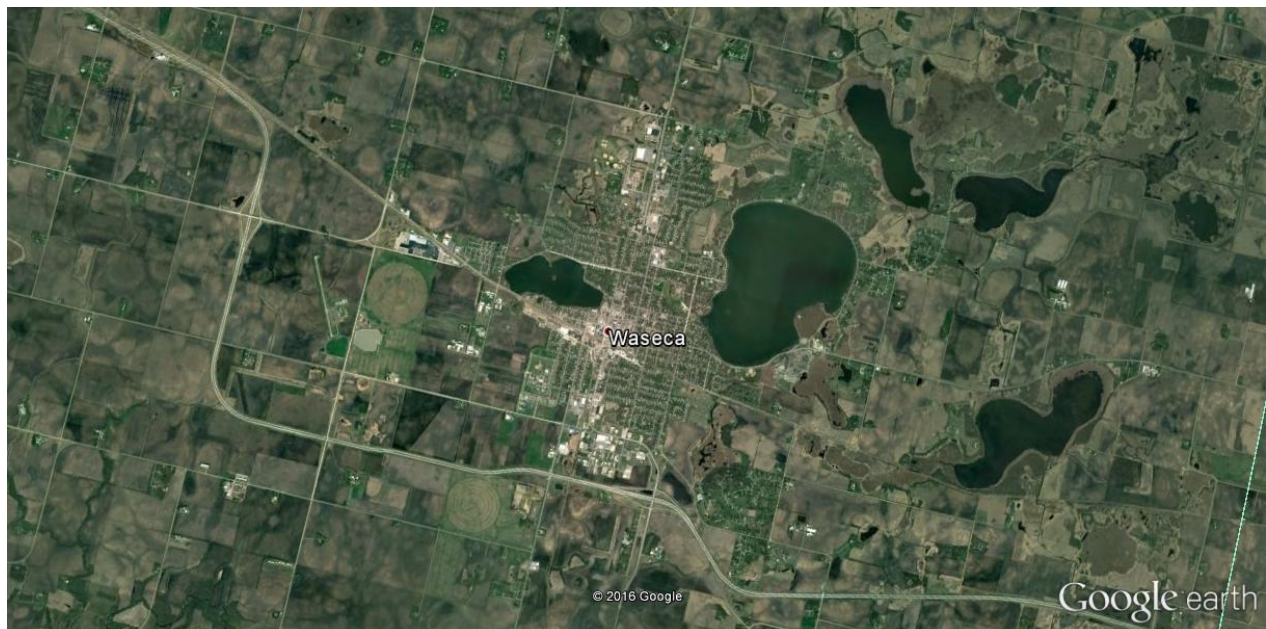
A debt coverage ratio (cash flow/annual debt service) of a minimum of 1.2 times is required and 1.4 times is typically preferred by lenders. This analysis shows that the hotel is projected to generate sufficient cash flow to meet its debt service requirements. Also, in this simple analysis, the projected cash on cash return on equity reaches nearly 7 percent in the hotel's third year and reaches nearly 11 percent in the fifth year. These returns are in the range of economic feasibility. To the extent that any financial incentives may be obtained, the viability of the project would be enhanced

Therefore, under the project cost and terms of financing assumptions utilized in this analysis, we conclude that the hotel project is economically feasible.

SECTION 3: SITE ANALYSIS

A bypass for U.S. Highway 14 around Waseca was completed in 2012. The new four lane divided highway has two Waseca interchanges: a southern access at State Street and a western access at 360th Avenue. We believe that the best location for a new hotel will be at one of these interchanges to allow for capture of highway traffic. A location that is visible from the highway will be much more effective in attracting this lodging segment, as travelers are likely to continue on to Mankato or Owatonna if the hotel cannot be seen.

Since there is no commercial activity at either interchange, we believe that a new hotel should be accompanied by at least a fuel station/convenience store. Such a development will help to stop traffic and reduce the impression of isolation by creating more lights and activity. Ideally, a restaurant adjacent to the hotel would be an attractive amenity for hotel guests, particularly for those who may not want to venture into downtown Waseca.



SOUTHERN INTERCHANGE

The southern exchange at State Street leads directly into the downtown and provides convenient access to the Waseca Industrial Park. Most of the city's restaurants are located along State Street, to the north of the central core. An aerial map of the southern interchange area is shown on the following page.



There is very limited land available for development in either northern quadrant. The vacant parcel in the northeast quadrant is zoned Highway Overlay; it is very low and is reported to have very poor soil. Similarly, the vacant parcel in the northwest quadrant is low as well and visibility from State Street is blocked by a hill.

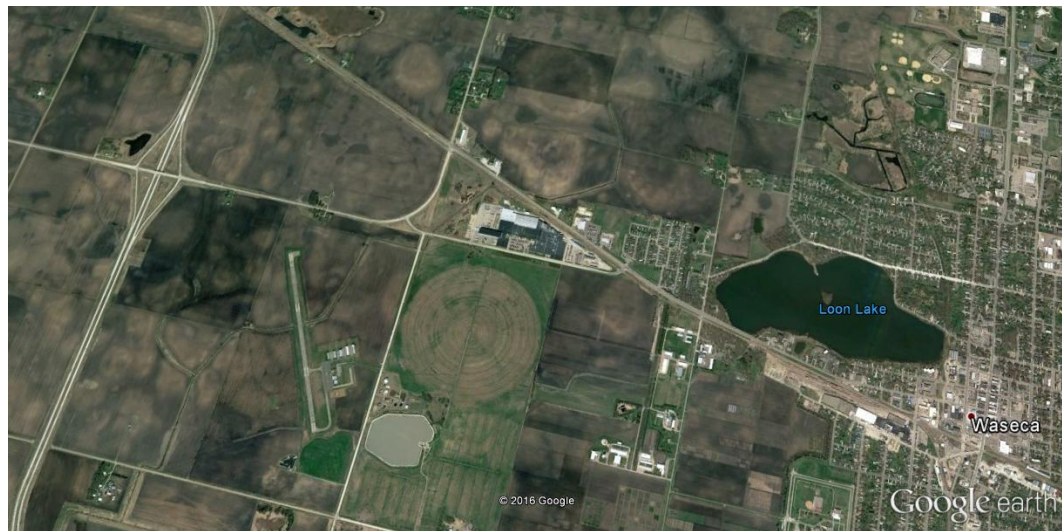
The area south of the highway is presently farm land. There is a limited area in the southeast quadrant that is zoned Highway Commercial. The rest of the land south of the highway is zoned for agriculture. Sewer and water for a hotel in this area would have to be extended from the north side of the highway.

Visibility of the quadrants at the interchange is generally good, although somewhat obscured by the overpass. The northwest quadrant is completely blocked for westbound travelers by a hill. The exit ramps in both directions

are unusually long so that it is more difficult to identify the businesses located at the interchange at the time the exit decision must be made.

WESTERN INTERCHANGE

The western interchange (at 360th Avenue) lies approximately 2.8 miles west of downtown Waseca. It is conveniently located to Quad Graphics, but is otherwise devoid of any commercial development, other than a car dealership. A restaurant would be required for a successful hotel development at this interchange.



The land in all four quadrants is relatively level and is zoned Highway Commercial. It is presently used for agriculture and the surrounding land is zoned for agriculture. The City is planning on extending sewer and water out to the interchange.

The visibility of this interchange is excellent from both directions on Highway 14; a hotel may be somewhat obscured by the overpass, but a pylon sign would be easily visible.

A hotel, restaurant and fuel station at this interchange would create a good anchor for further development in the area where developable land is abundant. It would likely encourage commercial development along 360th Avenue between the highway and downtown as well.

SECTION 4: REGIONAL CHARACTERISTICS

INTRODUCTION

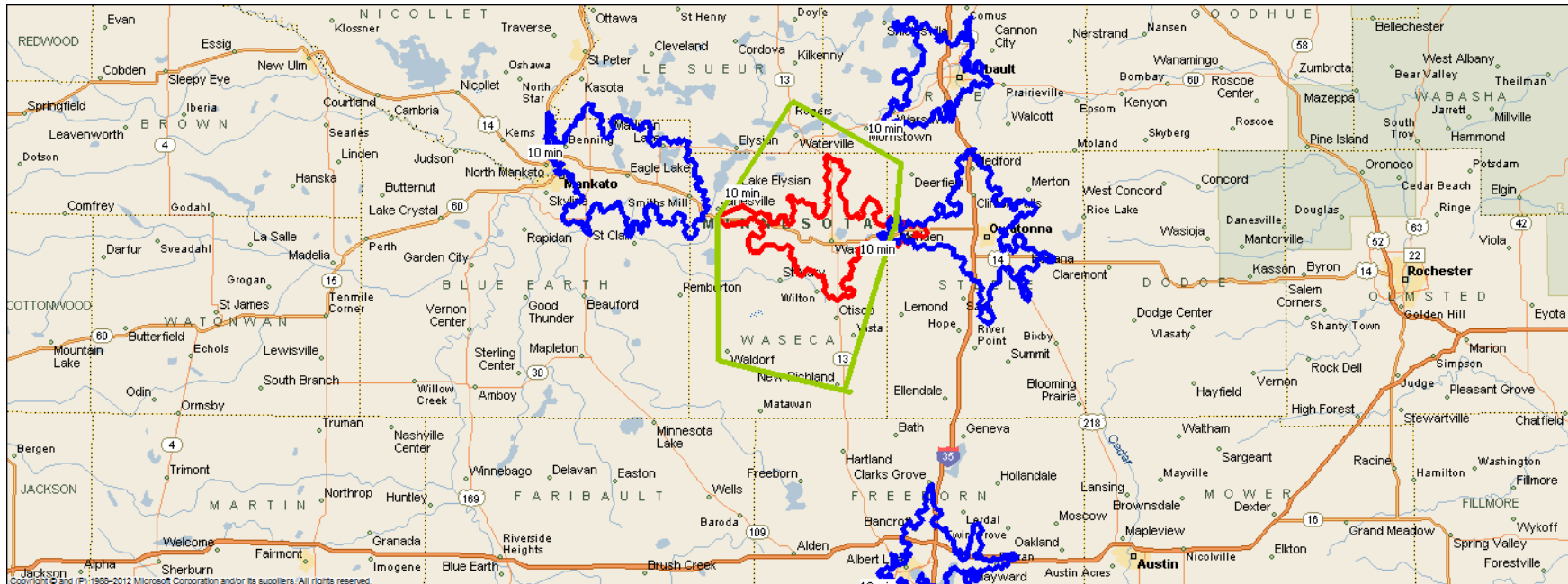
The following section provides an overview of the market environment within which a new hotel would operate. Included within this section is a review of selected economic and demographic data, along with descriptions of the transportation infrastructure, tourism and attractions in the area.

LOCATION

The City of Waseca is located near the center of Waseca County in south central Minnesota. It is located approximately 15 miles west of Owatonna and 30 miles east of Mankato.

Recent improvements to U.S. Highway 14 provide for easy access to Interstate 35 at Owatonna, and to the Mankato area. The local hotel market is restricted to the east by hotels in Owatonna, to the south by hotels in Albert Lea, and to the west by hotels in Mankato. The subject hotel's location and primary market are shown on the map on the following page. The irregular red line depicts a 10-minute drive time around surrounding communities. The green outline represents the subject hotel's primary market area.

**Waseca, MN
Primary Hotel Market Area**



DEMOGRAPHICS

The population of Waseca is reported to be approximately 9,400 people. Population statistics for Waseca, Waseca County, and the State of Minnesota are presented in the table below. Between 2000 and 2010, the population of Waseca increased by more than 11 percent, representing a compound annual average growth rate of 1.1 percent. Waseca County lost 2 percent of its population over the decade, while the state's population increased by 0.8 percent.

POPULATION CHANGE

	Market Area			Compound Annual Growth
	2000	2010	Change	
Waseca	8,461	9,410	11.2%	1.1%
Waseca County	19,517	19,132	-2.0%	-0.2%
Minnesota	4,919,479	5,303,925	7.8%	0.8%

Source: U.S. Census

Population projections prepared by the Minnesota State Demographic Center for 2015 to 2025 are presented in the following table. They show that Waseca County is expected to reverse the trend of population loss that occurred between 2000 and 2010 and increase by nearly 4 percent. While positive, this expected increase is still less than the state projected growth of 6.5 percent.

POPULATION PROJECTIONS

	Estimated 2015	2025	Increase 2015-2025	Compound 2015-2025
Waseca County	19,393	20,154	3.9%	0.4%
Minnesota	5,489,592	5,844,466	6.5%	0.6%

Source: Minnesota State Demographic Center

Household Incomes

The median household incomes for Waseca, Waseca County, the State of Minnesota, and the United States are shown in the following table. The median is the midpoint at which there are an equal number of households with larger and smaller incomes. The median household income in Waseca is 25 percent lower than the state median and Waseca County is 13 percent lower than the median for the state. Waseca County median income is very close to the national median.

MEDIAN HOUSEHOLD INCOME 2015

Waseca	\$46,167
Waseca County	\$53,564
Minnesota	\$61,492
United States	\$53,889

Source: U.S. Census

EMPLOYMENT

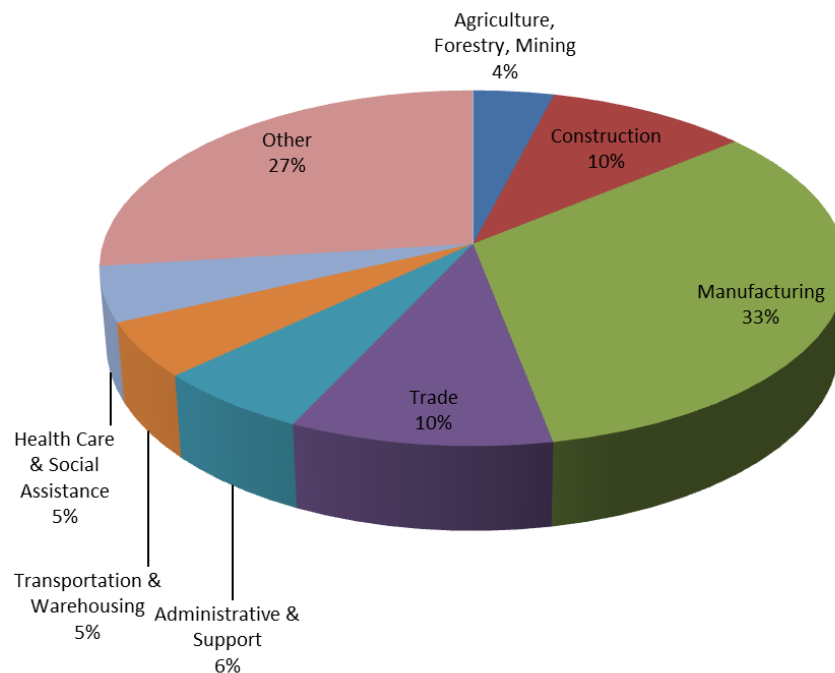
Employment is a strong indicator of an area's economic health. Waseca has a large Manufacturing sector that accounts for one third of the city's employment. Manufacturing is typically a strong generator of lodging demand as vendors, customers, corporate personnel, and sales meeting participants frequently require lodging accommodations.

Major Employers

There are four large manufacturing companies and a federal prison located in Waseca. These businesses are described below.

Quad Graphics is an international printing company with 50 plants in the U.S. and plants in Europe and Latin America. The Waseca plant is a modern web offset printing facility that prints more than 800 weekly, biweekly and monthly special interest publications, consumer publications, business-to-business publications, catalogs and inserts for national clients. It employs approximately 490 people in Waseca.

Waseca Employment



ITRON, Inc. is a technology and services company that provides: electricity, gas, water and thermal energy measurement devices and control technology; communications systems; software; and consulting services. The company operates plants in 14 international locations and five U.S. locations; it is headquartered in Washington State. The manufacturing plant in Waseca has approximately 290 employees.

Cinch Connectivity Solutions manufactures a large variety of connectors used in electronic devices. Cinch is a Bel group company; Bel is listed on NASDAQ and distributes product throughout the world utilizing plants in Waseca, Europe, Middle East, Africa, and Asia. Approximately 205 people are employed at the local plant.

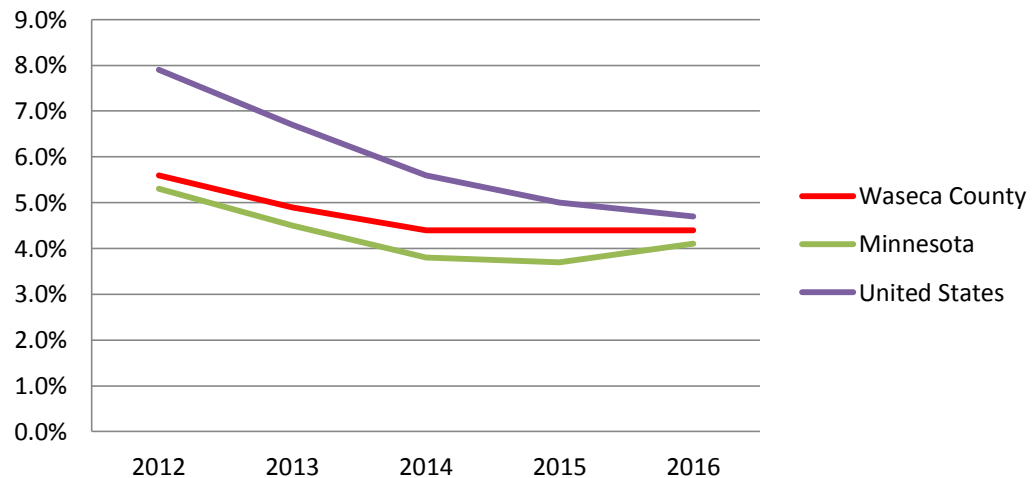
Birds Eye Division of Pinnacle Foods Group operates a vegetable processing plant in Waseca. It employs approximately 165 people.

Federal Correctional Institution is a prison operated for females by the Federal Bureau of Prisons in Waseca. The low security facility has a population of 1,070 inmates that originate from throughout the country. Visitation at the prison is held Friday evenings and all day on Saturdays and Sundays.

Unemployment

The unemployment rate in Waseca County as of December 2016 was 4.4 percent, a level that is higher than the Minnesota statewide rate of 4.1 and lower than the nationwide rate of 4.7 percent.

Unemployment Rate (December) Waseca County



Source: Federal Reserve Bank of St. Louis

TRANSPORTATION

Highways

Waseca is located at the intersection of State Highway 13 and U.S. Highway 14. Highway 13 connects Waseca with Shakopee, a southwestern suburb of Minneapolis to the north, and extends south to Albert Lea, where it becomes

U.S. Highway 69. Highway 69 parallels Interstate 35 south to Des Moines and Kansas City. Traffic counts taken by the Minnesota Department of Transportation show a daily average of approximately 2,800 vehicles travel on Highway 13 south of the city.

U.S. Highway 14 has been upgraded to a four-lane divided highway that extends across southern Minnesota and South Dakota, traveling between Rochester and Rapid City. Owatonna lies about 15 miles to the east of Waseca and Mankato lies about 30 miles to the west. A bypass was constructed around Waseca in 2012 which has two exits to the city. Traffic counts show a daily average of approximately 8,100 vehicles travel on the bypass near the southern exit and 7,300 travel near the western exit.

RESTAURANTS

Restaurants can be an important hotel requirement, particularly for commercial travelers. Waseca has several midscale restaurants that serve dinner:

- *Miller Armstrong Center* is a restaurant meeting complex located in downtown Waseca. The complex is located in a renovated grocery warehouse that is on the National Registry of Historic Buildings. There are three restaurants in the building: Club 57 is a bar and grill that serves burgers and sandwiches; Jonnie Beans is a coffee shop that serves breakfast and lunch; and Starfire Grille is fine dining that serves steaks, fish and pasta. Starfire Grille's dinners range from \$12 to \$26. This outlet only serves a fine dining menu Thursdays through Sundays.
- *El Molino Mexican Restaurant* is located in the downtown. It is a popular restaurant known to be one of the best in town. Its dinners are priced between \$11 and \$15.
- *Boathouse Grill and Bar* is a popular supper club located on Clear Lake. Its dinners are priced between \$13 and \$19.
- *El Tequila Mexican Grill* is another popular restaurant serving Mexican cuisine with dinners priced from \$10 to \$15.

Several employers mentioned that visitors frequently stay in surrounding communities because there is a wider choice of restaurants available.

AREA ATTRACTIONS

Several of the institutions and attractions that draw visitors to the Waseca area are described below.

Mayo Clinic Health System

This medical complex consists of a clinic and a 25-bed hospital. The hospital supports clinics in the surrounding communities of Waterville and Janesville. The medical complex is part of a system with more than 60 sites in Minnesota, Wisconsin, Iowa, and Georgia. The clinic has ten physicians that cover four specialties.

Farmamerica Center

The Minnesota Agricultural Interpretive Center, known as the Farmameica Center, was established by the Minnesota legislature in 1978 to preserve the state's rich agricultural heritage. The Center is located approximately five miles west of Waseca. The 360-acre site includes an old country church, several other historical buildings, a pond, prairie restoration, and a large collection of antique tractors and farm equipment. A visitor center was added in 2000 that rents out space for public functions. Its exhibition gallery and a multipurpose room each can accommodate up to 120 people for a banquet and up to 150 people for an event with theater seating. These spaces are supported by an on-site catering kitchen.

The center promotes itself as a wedding venue where the ceremony can be held in the old country church (which can seat 100) and the reception held in the visitors center. An official at the Center indicated that they usually host around ten functions a year that require lodging accommodations, the majority of which are weddings.

NEIGHBORING COMMUNITIES

Our market research found that a large portion of Waseca's commercial lodging demand goes to upper midscale hotels located in nearby Mankato and Owatonna. Pertinent attributes of these communities are described below.

Mankato

Mankato is a community of 40,000 located 30 miles west of Waseca on U.S. Highway 14. A branch of the University of Minnesota is a major economic driver. The U of M-Mankato has approximately 14,500 fulltime students. In addition to over 100 undergraduate programs, the university offers 75 masters programs and four doctoral programs. It competes in the NCAA Division II athletic conference, except for hockey where it competes in Division I.

River Hills Mall, an 814,400- square foot regional shopping center with 81 stores, is located on the eastern edge of the city. This popular mall is anchored by Barnes & Noble, Scheels All Sports, JC Penney, and Target. There are also a variety of restaurants near the mall.

There are 12 franchised hotels with a total of 961 rooms serving the community.

Owatonna

Owatonna is a community of 26,000 located 15 miles east of Waseca on U.S. Highway 14. Located on Interstate 35, there are 7 franchised hotels with a total of 485 rooms serving the community.

SECTION 5: AREA HOTEL SUPPLY

A new hotel would capture lodging demand from business activities in and around Waseca, through travelers on U.S. Highway 14, visitors to area residents, visitors drawn by athletic tournaments, and community events.

In this section of the report we present information regarding the area's hotels that would be competitive with a new hotel in Waseca.

HOTEL SUPPLY

The proposed hotel would compete with one of the two existing hotels in Waseca, and would recapture demand that presently stays in upper midscale hotels in Mankato and Owatonna.

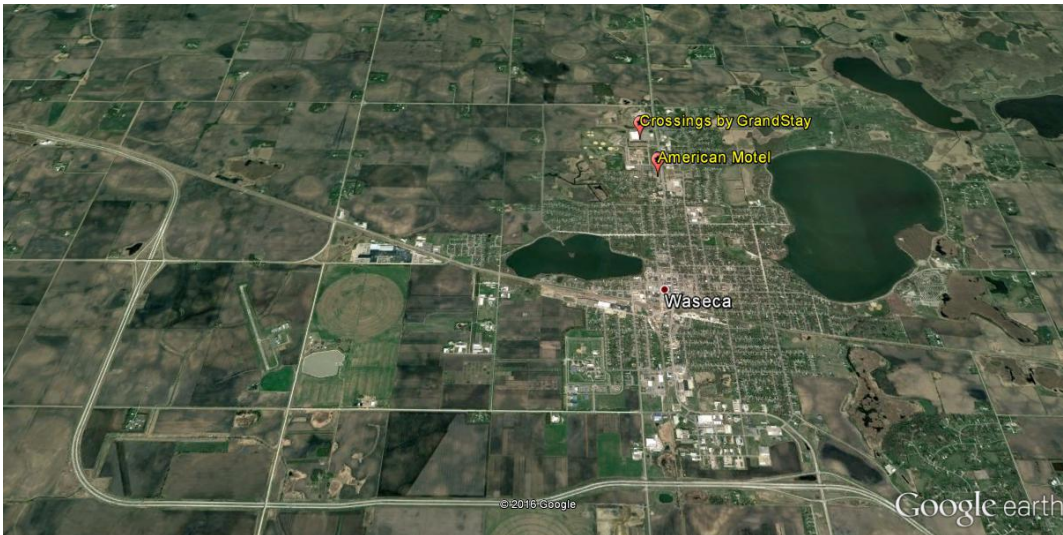
Waseca Lodging Supply

There are two lodging properties in Waseca with a total of 88 guest rooms. Key characteristics of these hotels are summarized in the following table.

WASECA HOTELS

Hotel	Rooms	Quality	Age	Amenities
Crossings by GrandStay	37	Midscale	20 Years	Pool, hot breakfast, small meeting room
American Motel	51	Economy	30 Years	Internet, limited continental breakfast
	178			

Only the Crossings would be considered to be directly competitive with a new hotel. The American Motel is an older economy class property but does accommodate some leisure demand that might upgrade to a new hotel. The locations of the Waseca hotels are shown on the following map.



Crossings by GrandStay



This 37-room hotel is located along State Street (Minnesota highway 13) near the northern edge of the city. It is flanked by the ITRON manufacturing plant to the north and Walmart to the south. This hotel opened in 1997 and has operated as a Crossings by GrandStay in recent years. GrandStay is a regional franchise with 25 properties located in Minnesota, Wisconsin, South Dakota, North Dakota,

and Iowa. Crossings is a brand used for hotels that have been converted from another franchise. There are six Crossings by GrandStay in Minnesota.

The hotel was purchased by a new owner in spring 2015 who is in the process of upgrading the property. Its amenities include an indoor pool, a small meeting room, and it serves guests a hot breakfast. Room rates at this midscale property are \$90 during the week with a corporate rate of \$84. A daily rate of \$69 is available for weekly stays. Rates are increased by \$10 on most weekends. We estimate the hotel will achieve an average rate of between \$85 and \$90 in 2017.

American Motel



This 51-room hotel is also located along State Street, but closer to the downtown. This hotel opened as an AmericInn in 1987 and is now operated without a franchise. Its amenities are limited to a continental breakfast for guests, free internet access, and

vending machines. Room rates at this economy property are \$63 to \$70. Rates are increased by \$10 on most weekends. We estimate the hotel will achieve an average rate of between \$65 and \$70 in 2017.

This property has a good rating on Hotels.com but reviews on Trip Advisor are generally quite poor, with complaints about uncomfortable mattresses and outdated facilities.

Other Competitive Hotels

Based on our market research, we identified three hotels located in two surrounding communities that accommodate lodging demand from Waseca. Two of these hotels are located in Mankato, approximately 25 minutes west of Waseca and one is located in Owatonna, approximately 20 minutes to the east.

The three hotels found to be competitive with a new hotel in Waseca are listed in the table below, along with their 2017 posted room rates.

COMPETITIVE AREA HOTELS

Hotel	Location	Quality	Year Opened	Rooms	Amenities
Holiday Inn Express & Suites	Mankato	Upper midscale	2009	88	2 Pools, whirlpool, fitness room, hot breakfast Small meeting room (408 sf)
Fairfield Inn & Suites	Mankato	Upper midscale	1997	61	Pool, hot breakfast
Holiday Inn & Suites	Owatonna	Upper midscale	2000	130	Restaurant, pub, water park, fitness room, Divisible meeting room (3,300 sf)

Holiday Inn Express & Suites – Mankato is an 88-room hotel located a small distance off of U.S. Highway 14 on the east side of the city. It is located near the River Hills Mall, an 18,400- square foot regional shopping center. This Intercontinental Hotel Group (IHG) franchise opened in 2009. Its amenities include a large recreational area that contains an indoor pool, a child pool, and whirlpool. Other amenities consist of a fitness room, a small meeting room, and a hot breakfast buffet for guests.

Room rates at this upper midscale property are \$143 during the week and are increased approximately \$30 on most weekends, as are rates during the summer. The hotel offers a 10% discount for none-refundable advance purchase and for seniors and corporate travelers. We estimate the hotel will achieve an average rate of between \$125 and \$130 for 2017.

Fairfield Inn & Suites-Mankato is a 61-room hotel also located a small distance off of U.S. Highway 14 on the east side of the city and near the River Hills Mall. This Marriott franchise opened in 1997. Its amenities include an indoor pool and a hot breakfast for guests.

Room rates at this upper midscale property are \$99 to \$109 during the week and are increased approximately \$30 on most weekends, as are rates during the summer. The hotel offers a 10% discount for none-refundable advance purchase and for seniors and corporate travelers. We estimate the hotel will achieve an average rate of between \$95 and \$100 for 2017.

Holiday Inn & Suites – Owatonna is a 130-room, full service hotel located off of Interstate 35 about four miles north of Owatonna. It is located in an industrial park and is close to a large 150,000-square foot Cabela's outfitter showroom, Timber Lodge Steak House, and Famous Dave's Bar-B-Que. This Intercontinental Hotel Group (IHG) franchise opened in 2000 and was fully renovated in 2010. Its amenities include a 14,000-square foot indoor water park, a pub restaurant, and a 3,300-square foot ballroom that can be divided into five meeting rooms.

Room rates at this upper midscale property are \$129 to \$150 during the week and are increased approximately \$20 on most weekends. Room rates during the summer are increased by approximately \$10. Five passes to the water park are included in the room rate. The hotel offers a 10% discount for none-refundable advance purchase and for seniors and corporate travelers. We estimate the hotel will achieve an average rate of between \$125 and \$130 for 2017.

MEETING FACILITIES

A community needs public space to accommodate functions such as business meetings, training sessions, seminars, banquets, fund raisers, reunions and receptions. Several decades ago, most hotels had restaurants and large meeting spaces to fulfill these needs. However, the development of large numbers of economy and limited service hotels that lack food service and meeting space have greatly reduced the number of new full service hotels. As a result, restaurants, golf clubs and banquet halls are capturing increasing shares of this business.

There is one venue in Waseca and two venues in the surrounding area that can accommodate group functions with more than 100 participants:

Miller Armstrong Center is a restaurant meeting complex located in downtown Waseca. The complex is located in a renovated grocery warehouse that is on the National Registry of Historic Buildings. The conference center consists of three different meeting rooms with capacities of 80, 96, and 120. There are three restaurants in the building and a bed and breakfast with four suites. Across the parking lot is the Star Event Center which has a capacity of 400 people and promotes itself for weddings, business conferences, reunions, and other social events.

Farmamerica Center, as described in the General Market section of this report, hosts around ten functions a year that require lodging accommodations, most of which are weddings. The Center has two spaces that are available for public functions, each can accommodate up to 120 for a banquet and 150 for an event with theater-style seating.

JR's Barn is a wedding venue located about 25 miles southwest of Waseca. The rustic barn with an unfinished interior promotes itself as a wedding venue. It features a 2,800-square foot ground level and a 2,200-square foot upper level. Banquet service for up to 250 people is available on the ground level and 175 on the second level. The venue also has a large deck, restrooms and changing rooms.

A new hotel would provide a high quality facility that would be suitable to accommodate visitors to these venues, many of whom currently stay in Mankato.

SECTION 6: AREA HOTEL DEMAND

HOTEL INDUSTRY TRENDS

The occupancies achieved by the hotel industry in 2014, 2015, and 2016 were the highest in the last 25 years. This was the result of increased commercial and leisure travel after the Recession, combined with a lack of new hotel supply which was thwarted during the Recession. Industry forecasts released by CBRE anticipate that the average national occupancy will achieve 65 percent in 2017, a level that is the same as the industry achieved in each of the last two years.

The increase in the number of new hotel rooms has caught up to and has even exceeded the growth in demand in many markets. CBRE forecasts that the growth in supply (at 2.0 percent) will exceed the growth in demand (1.8 percent) in 2017. However, continuing high occupancy levels will provide the leverage necessary to achieve large real average daily rate growth for the next two to three years. Average daily rates are forecast to increase by 4.1% next year.

The gains in ADR will offset the anticipated slight decline in occupancy, resulting in a forecasted gain in Revenue Per Available Room or RevPAR (average rate multiplied by occupancy) of 3.9%.

The increases in average daily rate that have occurred since 2009 have made new hotel construction feasible in many markets. The building standards, quality, and amenities required by hotel franchises resulted in project costs that previously could not be supported by the hotel rates that existed in many markets. As a result of the higher RevPARs experienced in recent years, hotel development activity is occurring in markets where a new hotel has not been developed in over a decade, or in small communities which have never had a hotel.

The hotel companies have developed new prototypes for this surge in development. These new facilities not only raise guest expectations for their lodging experience, but also push older prototype hotels closer to market obsolescence.

Recent lodging data supplied by STR Global data was obtained from the Minnesota Lodging Association to assess the region's growth patterns. This data showed that hotel demand in Southern Minnesota declined by -3.3% in 2016, after three previous years of increases. Between 2012 and 2015, lodging demand grew at an annual compound rate of 3.3 percent. Statewide hotel demand in Minnesota increased by 1.1 percent in 2016.

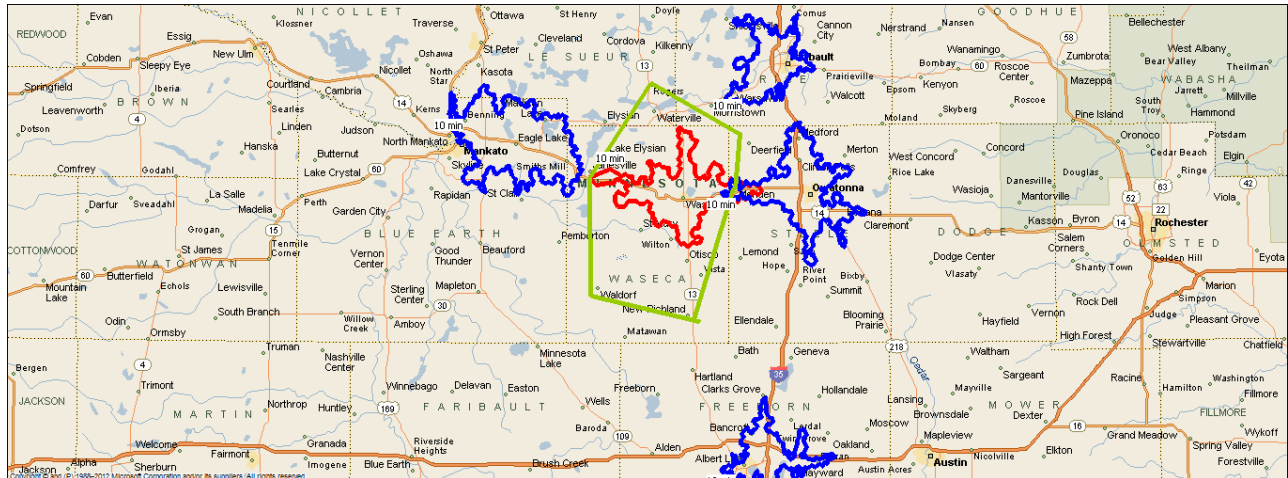
The data also shows that the lodging demand in the Northern Minnesota region declined by -4.0% in 2016. The declines recorded in both areas seems to indicate that tourist travel was reduced last year.

It appears that the recovery from the recession has, for the most part, occurred so that future growth in lodging demand will be the result of real growth, rather than catch-up.

HOTEL DEMAND

The size of Waseca's potential hotel market is limited by the proximity of Mankato to the west, Faribault and Owatonna to the east, and Albert Lea to the south, as shown on the map below. The primary market area is depicted by the green shape and the irregular shapes represent a 10-minute drive time zone around Waseca and the surrounding cities with midscale hotels.

The actual market areas for Mankato and Owatonna are expanded beyond what is depicted on the map due to the existence of highly popular hotel franchises representing Marriott, Hilton and Holiday Inn, as well as shopping and restaurants in these communities.



A new upper midscale hotel in Waseca would capture local commercial, group, and leisure demand that is leaving the market now due to the lack of new hotel facilities. In order to quantify the amount of lodging demand that exists in the community, we obtained lodging tax data to evaluate recent trends regarding both the levels of demand and seasonality that is accommodated by the existing competitive hotels. In addition, we contacted area companies to gain insight into their lodging needs and to identify the hotels they utilize.

In conducting our market analysis, we looked at the characteristics of each demand component. A description of these characteristics follows.

Commercial Demand

Commercial demand occurs steadily throughout the year with little seasonal fluctuations other than a decline in business travel during holiday periods. This segment of demand occurs mostly during the weekdays. It originates from vendors, customers, sales meetings, and other business related travelers in the area.

Commercial travelers generally seek out franchised hotels that are located near their business destination. Since they are typically on expense accounts, many seek out the newer and higher quality hotels. The availability of a conveniently located quality restaurant is often an important factor in hotel selection for this segment.

Discussions with representatives of the larger companies found that very few of their visitors stay in the local Waseca hotels, due primarily to the lack of modern hotel facilities. The majority seek lodging in Mankato (at the Courtyard by Marriott, Fairfield Inn & Suites, or Hilton Garden Inn) or in Owatonna (at the Holiday Inn & Suites). An officer at Quad Graphics stated a strong desire for a convenient new local hotel as its customers are frequently in town for several days and make multiple visits a day to the plant during the course of a printing project.

Leisure Demand

The Leisure demand segment consists primarily of reunions and other social gatherings, visitors to local friends and relatives, hockey tournaments, and visitors to the area's special events. Convenience is typically important to these travelers. However, the manager at the community ice rink mentioned that, although some participants stay in Waseca, many tournament visitors prefer to stay in Mankato because of the entertainment and shopping options available there. The leisure market segment is largest during the summer months, when leisure travel is at its peak, and reaches its low point in December and January. Leisure demand is typically more price sensitive than commercial demand.

Group Demand

Group business is generated by area employers who hold training sessions, sales meetings and planning sessions, government agencies, associations and area residents who hold weddings, reunions and other social gatherings attended by a number of out-of-town guests. A representative of the FarmAmerica Center reports hosting approximately 10 weddings a year which require lodging accommodations.

AREA HOTEL PERFORMANCE

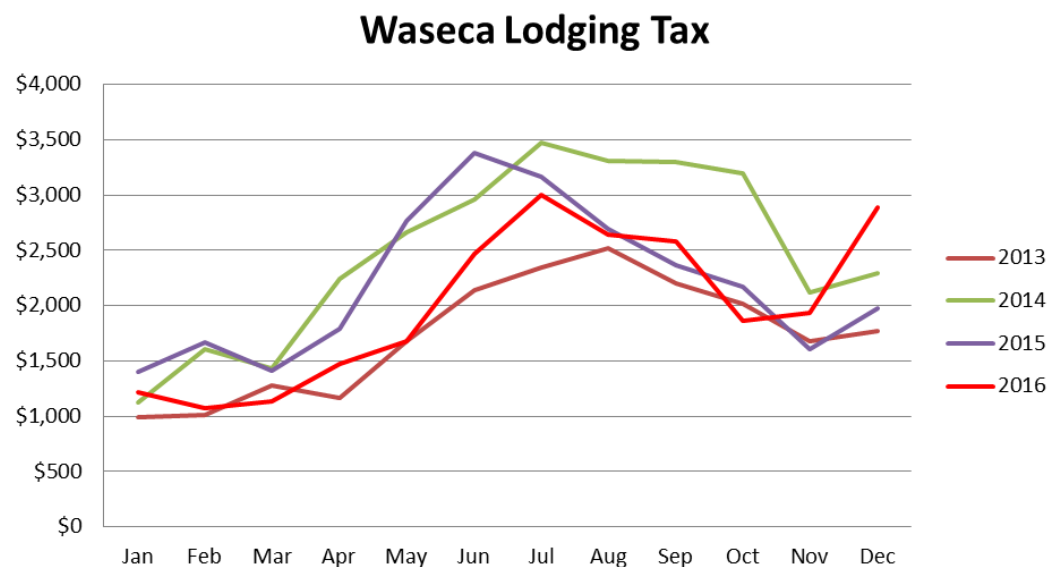
In order to assess the recent business trends in the area lodging market, we obtained several years of lodging tax data for Waseca.

Lodging Revenues

Waseca collects a 3 percent lodging tax from its hotels. The tax is collected on

room rentals of less than 30 consecutive days. Long term rentals for a period of more than 30 days are therefore not reflected in these data.

The tax revenue, which represents a combination of occupancy and room rates, shows that revenue peaked in 2014, as illustrated in the graph below. It was explained to us that a large number of highway construction workers stayed in Waseca during this period which resulted in unusually high occupancies. Lodging revenue declined by 11 percent in 2015 and by another 9 percent in 2016. The graph also provides an indication of the seasonality of lodging demand which peaks during the summer months.



Source: City of Waseca

Estimated Hotel Performance

Based on our market research and data available to us, we have estimated the occupancy and average daily room rate for the two hotels judged to be competitive with a new hotel in Waseca. These hotels are summarized in the following table.

COMPETITIVE AREA HOTELS

Hotel	Quality	2017 Rack Rates		Weekend Premium	Estimated 2016 ADR	Estimated 2016 Occupancy
		Regular	Suite			
Crossings by GrandStay	Midscale	\$85-\$90	\$115	\$10	\$85-\$90	45%-50%
American Motel	Midscale	\$63-\$75	na	\$10	\$65-\$70	20%-25%

HOTEL DEMAND PROJECTIONS

For purposes of our demand analysis, we have assumed that the Crossings by Grandstay would be directly competitive with a new hotel and the American Inn would be partially competitive, primarily for leisure demand. We also believe that a new hotel could capture some of the Waseca demand that presently stays in Mankato and Owatonna. If visible from Highway 14 and surrounded by some other retail establishments, the hotel would capture some highway travelers as well.

The two competitive hotels in Waseca, with a total of 88 guest rooms, are estimated to have experienced around 10,000 occupied roomnights in 2016. Our interviews with local companies found that a large portion of lodging demand leaves the market in search of higher quality hotel facilities. **Based on our observations, research and analysis, we believe the current hotel supply to be somewhat obsolete and insufficient to meet a large portion of the community's lodging needs.**

Accordingly, we estimate that a new hotel of upper midscale quality with a strong franchise could retain approximately 4,200 annual roomnights that are now leaving the Waseca market.

In addition, we estimate that a new hotel could attract approximately 2,400 new roomnights to the market arising from business off of the highway and new leisure and group business hosted due to the availability of high quality hotel facilities.

Based on our market research, the quantity and mix of the competitive lodging demand is estimated to consist of the following:

Estimated Potential Waseca Hotel Demand (2016)

Market Segment	Total	Commercial	Leisure	Group
Two Competitive Hotels	10,000	4,800	4,700	500
Recapture Demand Leaving Market	4,200	2,400	1,600	200
New Business	2,400	600	1,400	400
Totals	16,600	7,800	7,700	1,100
Percent of Total	100%	47%	46%	7%

We estimate that approximately 47percent of the potential lodging demand in the area market is generated by commercial activity, 46 percent is generated by leisure travelers, and 7 percent is generated by meetings and other group functions.

Lodging Demand Growth

In estimating future levels of the market's lodging demand, we considered the following factors:

1. The hotel industry is tied directly to the regional and national economy. As the economy recovered after the recession both business and leisure travelers returned to the road, resulting in annual demand growth rates of between 2.0 and 4.7 over the last three years and an estimated 1.7 percent in 2016. CB Richard Ellis forecasts demand to increase by 1.8 percent in 2017 and continue a long run average growth at this rate.
2. The lodging demand accommodated by the Waseca hotels declined by - 3.3 percent in 2016 after having grown at a compound annual rate of 3.3 percent over the previous three years.
3. The population of Waseca grew at a compound annual rate of 1.1 percent between 2000 and 2010, while Waseca County's population declined at a compound annual rate of -0.2 percent. The population of Waseca County is projected to increase at a compound annual rate of 0.6 percent between 2015 and 2025.
5. The additional hotel capacity will allow the market to accommodate more demand during the times when the local hotels are full.

Based on these factors of growth, we have assumed an annual 1.0 percent growth in the area's base lodging demand. In addition to this growth in the lodging base, new demand will be attracted by the subject hotel's modern facilities and franchise, and the increased capacity during periods when the market is sold out.

The projected market growth is summarized below. The large increase shown for 2019 reflects the capture of demand that presently is leaving the market.

**PROJECTED LODGING DEMAND
Competitive Waseca Market**

<u>Year</u>	<u>Available Rooms</u>	<u>Demand (Roomnights)</u>	<u>Annual Growth</u>
2016	32,120	9,986	
2017	32,120	10,086	1.0%
2018	32,120	10,187	1.0%
2019(1)	50,370	16,271	59.7%
2020	50,370	16,904	3.9%
2021	50,370	17,276	2.2%
2022	50,370	17,449	1.0%
2023	50,370	17,624	1.0%

Note 1: Assumes 50-room hotel opens

SECTION 7: RECOMMENDED FACILITIES

This section of the report presents the facilities that are recommended for a new hotel in Waseca. Estimates of the utilization of the hotel are presented in the next section of the report.

DEVELOPMENT TRENDS

New full service hotels have all but disappeared in recent years for locations other than urban areas, large office parks, and corporate centers. This is due to their higher cost (and higher room rates) relative to limited service hotels that can offer the same quality room but at a lower rate. Several hybrid concepts, known as “focused service” hotels, have emerged that offer a limited menu buffet restaurant and a small bar. Hilton Garden Inn and Courtyard by Marriott are examples of this concept. Due to the challenges of operating a restaurant, full service hotels are also considered to be of greater risk by lenders and investors.

HOTEL FACILITY RECOMMENDATIONS

Based on our evaluation of the local hotel supply and demand conditions we believe that an upper midscale hotel with approximately 50 rooms carrying a well-recognized national franchise should be considered for Waseca. Examples of possible considerations are:

Marriott International:	Fairfield Inn & Suites
Hilton Hotels & Resorts:	Hampton Inn & Suites
Intercontinental Hotels Group:	Holiday Inn Express
Carlson-Rezidor Hotel Group:	Country Inn & Suites
Choice Hotels:	Comfort Inn & Suites

These upper midscale hotels are all limited service properties in that they do not have restaurants and typically offer smaller meeting spaces. They all provide

breakfast free of charge to hotel guests. Other amenities include an indoor pool, a room with fitness equipment, high speed wireless internet access, a business center, and a guest laundry. The size of meeting space depends on the opportunities in the local market. These hotels provide great value to guests because they provide high quality rooms and amenities without the financial burden of operating a restaurant.

We suggest that three or four 1-bedroom suites be included in the hotel; at least one should have kitchen facilities. The suits will appeal to traveling families, employee transfers, lengthy professional assignments, new home construction, and other situations that create a long term hotel stay situation.

We also recommend that a small meeting room of approximately 500 square feet be included in the hotel to accommodate small business meetings and social events.

SECTION 8: UTILIZATION PROJECTIONS

Based upon an assessment of the market demand, we have estimated the potential utilization for the recommended hotel's first five full years of operation, assumed to begin in 2019 and stabilize in 2021. In developing the utilization estimates, several key assumptions were made including the following:

- The hotel will obtain and be operated under a national franchise;
- The hotel will be competently managed;
- Hotel management will implement a comprehensive program of on-going maintenance covering all facilities, furnishings and equipment;
- Management will conduct an aggressive program of pre-opening marketing for the hotel and will continue an effective program of advertising and group promotions targeted toward area groups and social gatherings throughout the projection period; and
- No new hotels, other than the subject, will be constructed in Waseca during the projection period.

In addition, all findings, estimates, assumptions and conclusions discussed in this report are integral parts of the analyses and estimates that follow.

PROJECTED OCCUPANCY

In order to calculate the occupancy that the subject hotel is projected to achieve, we looked at the performance of the other competitive hotels in the primary market and analyzed the lodging demand that is generated by employers, leisure visitors, and Waseca activities.

Customer Loyalty

There is a trend within the hotel industry whereby guests select a hotel based on its company's rewards program, rather than on convenience of location, room rates or amenities. The large franchise companies award points for staying in their hotels which can then be redeemed for free or discounted stays at any hotel within their respective chains. Thus, it is not unusual for travelers to drive an extra distance to stay at a hotel whose rewards program they participate in.

Marriott, Hilton, and Intercontinental Hotel Group have the most popular programs, as they have hotels throughout the world, including a number of popular resorts, where rewards can be redeemed. Choice Hotels has a liberal rewards program that provides free hotel rooms, but its inventory of hotels and resorts is not nearly as extensive as the three aforementioned hotel companies.

This factor can distort the competitive environment within a particular hotel market. Thus, a new hotel in Waseca will continue to face competition from the two Marriott franchises in Mankato (Fairfield Inn & Suites and the Courtyard), the Hilton franchise (Hilton Garden Inn), and the Intercontinental Hotel Groups franchise (Holiday Inn Express). The Holiday Inn & Suites in Owatonna will similarly draw some loyal travelers from Waseca.

Projected Hotel Utilization

A new hotel would capture some demand from existing hotels, recapture much of the demand that is leaving the market, attract new demand, and provide capacity for additional business during periods when local hotels are full.

In preparing the utilization estimates, we considered the hotel's competitive advantages:

- Newest hotel and the only upper midscale property in the market; and
- Site location that is highly visible and easily accessible from Highway 14.

We also considered the fact that a new hotel will have to compete with existing hotels in adjacent communities that are franchised by Marriott, Hilton, and International Hotel Group which are well-established hotel chains with loyal followings.

By calculating the ratio of the rooms available at the subject hotel to the total number of rooms available within the competitive market, the “fair share” percentage of demand for the hotel may be determined. The fair share calculation reflects the market share that the hotel could expect to capture if all available competitive rooms in the market were favored equally by potential guests and choices were made on a purely random basis. The recommended 50 room hotel represents 36 percent of the primary competitive supply consisting of the Crossings by GrandStay and the American Motel ($50 / 138 = 36.2\%$).

Based on the results of our market study, we estimate that the subject hotel would be able to capture 111 percent of its fair share of the demand currently being accommodated by the two Waseca hotels. The higher room rates charged by the new hotel compared to the existing ones would override the higher quality for some of the hotel demand and therefore prevent the new hotel from achieving a larger market share.

In addition, we believe that the new hotel could recapture much of the demand that is leaving the market to stay in hotels located in neighboring communities. It will also attract some demand from through travelers on Highway 14 and will stimulate new leisure and group demand. We have calculated this recaptured and new demand to be 65 percent of the total demand that is currently being captured by the two local hotels.

The size and segmentation of the lodging demand available to the new hotel is summarized in the following table.

Estimated Potential Waseca Hotel Demand (2016)

Market Segment	Total	Commercial	Leisure	Group
Two Competitive Hotels	10,000	4,800	4,700	500
Recapture Demand Leaving Market	4,200	2,400	1,600	200
New Business	2,400	600	1,400	400
Totals	16,600	7,800	7,700	1,100
Percent of Total	100%	47%	46%	7%

The results of our utilization analysis are presented in the following table, which show the subject hotel achieving projected annual occupancies that range from 53 percent in its first year to 61 percent in its fourth and fifth year.

RECOMMENDED HOTEL
Projected Market Mix and Occupancy
50 Rooms

Market Segment	2019	2020	2021	2022	2023
Commercial	4,200	4,500	4,700	4,800	4,800
Leisure Travelers	4,900	5,300	5,500	5,600	5,700
Group	600	700	700	700	700
Totals	9,700	10,500	10,900	11,100	11,200
Annual Occupancy	53%	58%	60%	61%	61%

Occupancies projected for the first two years are lower than the stabilized level of operation, as the hotel will require time to develop its marketing program, particularly for group business, and to maximize public awareness of the hotel facilities. Its market penetration should stabilize in its third year of operation.

Market Mix

The mix of the hotel's lodging demand at its stabilized level of operation is estimated to be the following:

STABILIZED MARKET MIX**50-Room Hotel**

Market Segment	2021	% of Total
Commercial	4,700	43%
Leisure	5,500	50%
Group	700	6%
Totals	10,900	100%

PROJECTED AVERAGE RATE

The analysis from which we developed our projections of average daily rate for the subject hotel included the quality and pricing structure of the other area hotels. As shown in the table below, current rates for regular rooms at the upper midscale hotels in the area range from \$90 to \$150.

The average daily rate at a hotel falls below its rack rates due to the numerous discounts that are offered to guests and large corporate clients, and to lower rates charged during slack periods. The estimated average rates at the competitive hotels for 2016 ranged between \$85 and \$130.

COMPETITIVE AREA HOTELS

Hotel	Location	Quality	2017 Rack Rates	Weekend Premium	Estimated 2016 ADR
			Regular		
Crossings by GrandStay	Waseca	Midscale	\$90	\$10	\$85-\$90
American Motel	Waseca	Midscale	\$63-\$75	\$0	\$65-\$70
Holiday Inn Express & Suites	Mankato	Upper Midscale	\$143	\$30	\$125-\$130
Fairfield Inn & Suites	Mankato	Upper Midscale	\$99-\$109	\$30	\$90-\$95
Holiday Inn & Suites	Owatonna	Upper Midscale	\$129-\$150	\$10	\$115-\$120

Based on our analysis, we have determined that a new upper midscale hotel in Waseca should be able to achieve an average rate of \$105 expressed in 2016 dollars. The industry-wide ADR is forecasted to increase at an average of 3.0 percent annually over the next few years. We believe that the subject hotel will be able to achieve a similar rate of increase in this market. Factored into the room rates projected for the subject hotel are an inflation factor of 2 percent

and a real growth factor of 1 percent. The total increase is projected to be 3 percent annually over the projection period. The inflated average rate in 2019, assumed to be its first full year of operation, is projected to be \$114.75.

WASECA HOTEL
Projected Average Daily Rate

Year	Average Daily Rate
2016	\$105.00
2019	\$114.74
2020	\$118.18
2021	\$121.72
2022	\$125.38
2023	\$129.14

PROJECTED ROOM REVENUE

Based on the occupancy and average rate projections developed in this market study, we project that the subject hotel should be able to achieve the levels of room sales shown in the table below.

FINANCIAL PROJECTION SUMMARY
50-ROOM UPPER MIDSOURCE HOTEL

	2019	2020	2021	2022	2023
Occupancy	53%	58%	60%	61%	61%
Average Daily Rate	\$111.39	\$114.74	\$118.18	\$121.72	\$125.38
Total Revenue	\$1,097,109	\$1,223,010	\$1,307,493	\$1,371,228	\$1,424,887
Departmental Expenses	(251,294)	(271,474)	(286,795)	(297,564)	(306,080)
Undistributed Expenses	(278,314)	(314,332)	(344,196)	(357,369)	(368,615)
Fixed Charges	(172,449)	(239,822)	(264,618)	(274,750)	(283,631)
Cash Flow For Debt Service	\$395,051	\$397,383	\$411,884	\$441,545	\$466,561

SECTION 9: FINANCIAL PROJECTIONS

Estimates of cash flow from operations before debt service have been prepared for the first five years of operation for the recommended hotel, with 2019 assumed to be the first full year of operation. The major assumptions as to the hotel occupancy and room rate are noted at the bottom of the projection columns and have been developed from an analysis of the local lodging market. The operating expense projections are derived from comparable hotels and industry data for small limited service hotels. All revenue and expense categories are consistent with the Uniform System of Accounts for Hotels.

Room revenues reflect an annual increase of 3.0 percent in the average daily rate for the projection period and other revenues have also been increased by 3.0 percent annually. Expense categories have been inflated at an annual rate of 2.0 percent. Many of the expenses were projected on an amount per occupied room basis, while the fixed expenses reflect only inflationary increases.

NOTES TO FINANCIAL PROJECTIONS

Revenue

Guest Room Revenue projections are based upon the occupancy and average rate estimates previously presented.

Meeting Room Rental projections reflect fees paid for use of the meeting room, mostly by outside groups who do not rent guest rooms.

Vending Income (net) projections reflect vending sales of soda and snacks sold at the hotel net of the cost of goods sold and machine lease fees.

Miscellaneous Income consists of movie rentals, guest laundry, interest and other ancillary revenue sources (net of the costs incurred to provide these items).

PROPOSED HOTEL - WASECA, MN PROJECTED CASH FLOW FROM OPERATIONS BEFORE DEBT SERVICE - 50 ROOMS										
	<u>2019</u>		<u>2020</u>		<u>2021</u>		<u>2022</u>		<u>2023</u>	
	AMOUNT	%	AMOUNT	%	AMOUNT	%	AMOUNT	%	AMOUNT	%
REVENUE:										
Rooms	\$1,112,942	98.5%	\$1,240,873	98.5%	\$1,326,789	98.6%	\$1,391,668	98.6%	\$1,446,332	98.6%
Meeting Room Revenue	5,830	0.5%	6,310	0.5%	6,551	0.5%	6,671	0.5%	6,731	0.5%
Vending Income (net)	1,590	0.1%	1,773	0.1%	1,895	0.1%	1,988	0.1%	2,066	0.1%
Miscellaneous Income (net)	9,162	0.8%	10,195	0.8%	10,901	0.8%	11,434	0.8%	11,884	0.8%
Total Revenue	1,129,524	100%	1,259,152	100%	1,346,137	100%	1,411,762	100%	1,467,013	100%
DEPARTMENTAL EXPENSES										
Rooms Departmental Expenses	251,294	22.6%	271,474	21.9%	286,795	21.6%	297,564	21.4%	306,080	21.2%
Total Departmental Profit	878,230	77.8%	987,678	78.4%	1,059,342	78.7%	1,114,197	78.9%	1,160,933	79.1%
UNDISTRIBUTED OPERATING EXPENSES										
Administrative & General Expenses	144,063	12.8%	155,081	12.3%	162,887	12.1%	169,097	12.0%	174,545	11.9%
Information & Telecommunications	6,010	0.5%	6,190	0.5%	6,376	0.5%	6,567	0.5%	6,764	0.5%
Marketing Expenses	50,082	4.4%	55,839	4.4%	59,706	4.4%	62,625	4.4%	65,085	4.4%
Utility Costs	58,674	5.2%	63,550	5.0%	66,673	5.0%	68,942	4.9%	70,796	4.8%
Property Operations & Maintenance	23,439	2.1%	38,081	3.0%	53,269	4.0%	55,082	3.9%	56,564	3.9%
Total Undistributed Operating Expenses	282,269	25.0%	318,741	25.3%	348,911	25.9%	362,314	25.7%	373,754	25.5%
GROSS OPERATING PROFIT	595,961	52.8%	668,937	53.1%	710,431	52.8%	751,883	53.3%	787,179	53.7%
Franchise Fee (Royalty)	55,647	4.9%	62,044	4.9%	66,339	4.9%	69,583	4.9%	72,317	4.9%
Management Fee	44,518	3.9%	49,635	3.9%	53,072	3.9%	55,667	3.9%	57,853	3.9%
INCOME BEFORE FIXED CHARGES	495,796	43.9%	557,259	44.3%	591,020	43.9%	626,633	44.4%	657,009	44.8%
FIXED CHARGES:										
Property Taxes	39,795	3.5%	81,182	6.4%	82,806	6.2%	84,462	6.0%	86,151	5.9%
Insurance	13,796	1.2%	14,072	1.1%	14,353	1.1%	14,640	1.0%	14,933	1.0%
Replacement Reserve	22,259	2.0%	37,226	3.0%	53,072	3.9%	55,667	3.9%	57,853	3.9%
Total Fixed Charges	75,850	6.7%	132,480	10.5%	150,231	11.2%	154,769	11.0%	158,938	10.8%
CASH FLOW AVAIL. FOR DEBT SERVICE	\$419,947	37.2%	\$424,778	33.7%	\$440,790	32.7%	\$471,864	33.4%	\$498,071	34.0%
OCCUPANCY	53%		58%		60%		61%		61%	
ADR	\$114.74		\$118.18		\$121.72		\$125.38		\$129.14	
OCCUPIED ROOMNIGHTS	9,700		10,500		10,900		11,100		11,200	
The comments and assumptions contained in the report are an integral part of these financial projections.										

Departmental Expenses

Rooms Departmental Expenses include payroll and related benefit expenses for the front desk and housekeeping. This category also includes franchise reservation fees and other miscellaneous rooms expenses such as breakfast expense, cleaning and guest room supplies, cable TV fees, linens and cleaning supplies, and other direct operating costs for the rooms

department. The projected expense has both a fixed and a variable component. The payroll component is relatively fixed, varying only slightly in response to changes in occupancy, as housekeeping staff and certain other hourly workers have variable schedules.

Undistributed Operating Expenses

Administrative and General Expenses include management and administrative payroll and the general costs associated with operating the hotel, including credit card commissions, bank charges, professional fees, travel and entertainment and other miscellaneous costs. The projected expense has both a fixed and a variable component.

Information and Telecommunication Expense consists of the costs associated with providing telephone and internet service to the hotel.

Marketing Expenses include the costs associated with advertising, sales and promotion, and include travel agent commissions, promotional materials, guest loyalty program costs, and other promotional expenditures. This expense includes a marketing fee paid to the franchisor assumed to be 2.0% of room revenue.

Utility Costs expense includes costs related to heating and cooling, electricity, gas, water and sewer. Utilities expense for the hotel is projected from a current base of \$5.70 per occupied room and includes both a fixed and a variable portion.

Property Operations & Maintenance expenses includes the costs associated with repairs, maintenance, grounds keeping, and other related property operating costs. The projected expense has both a fixed and a variable component. This expense is reduced in the early years as the hotel will be new and its equipment under warranty.

Franchise Fee is the royalty fee paid to the hotel franchisor and is calculated to be 5.0 percent of room revenue.

Management Fee – We have assumed that the hotel will be managed by an outside management company for a fee equal to 4.0 percent of room revenue.

Fixed Charges

Property tax expense is projected from an estimate of \$1,500 per room for the hotel based on the experience of existing hotels. In the first year, the tax expense assumes the complex is only half completed at the time of assessment.

Insurance expense is projected to be \$250 per room, similar to the premiums paid by other hotels with pools.

Replacement Reserve represents funds that will be set aside from operating cash flow to fund the future cost of replacing and upgrading furnishings and fixtures in the hotel that will be required to maintain its competitive standing in the market on a continuing basis. This reserve is calculated at 2.0 percent of projected room revenue in the first year, increasing by an additional 1.0 percent of revenue in each of the next two years and stabilizing at 4.0 percent.

ECONOMIC FEASIBILITY ANALYSIS

In order to test the economic feasibility of the project, we prepared an analysis of the project's ability to generate sufficient funds to cover its estimated debt service.

Project Cost

The following development budget estimate was prepared by Hospitality Consulting Group for purposes of testing the preliminary economic feasibility of the project. It is based on budgets from other hotel projects on which we have worked. However, the quality and scope of amenities selected for the actual project could cause the costs to vary significantly.

For analysis purposes, we have assumed the hotel to have a total cost of \$5,800,000, or approximately \$116,000 per guest room. This budget assumes a land cost estimate of \$10,000 per guest room or \$500,000. The budget does not include any costs associated with extending municipal utilities to the site.

Recommended 50-Room Hotel Waseca, MN

50 guest rooms with a pool, breakfast area, small meeting room, and a fitness center

	Cost	Per Room
Land	\$500,000	\$10,000
Utilities, Grading, Paving, Landscaping	200,000	4,000
Hotel Building Construction	3,500,000	70,000
Hotel Fixtures, Furnishings, and Equipment	600,000	12,000
Indirect Costs	1,000,000	20,000
Total	<u>\$5,800,000</u>	<u>\$116,000</u>

Financing Assumption

For analysis purposes we have assumed an equity investment of \$1,450,000 (25% of the project cost) leaving a loan of \$4,350,000 to provide funds for the \$5,800,000 total project cost.

Source of Funds:

Equity	\$1,450,000	25%
Debt	<u>4,350,000</u>	<u>75%</u>
	\$5,800,000	100%

Debt Term Assumptions:

Annual Interest Rate:	5.0%
Amortization:	20 years
Annual Payment:	\$344,497

The results of this analysis are presented in the following table.

Proposed Hotel-Waseca, MN
Economic Feasibility Analysis
Project Cost: \$5,800,000

	2019	2020	2021	2022	2023
Cash Flow Available for Debt Service	\$419,947	\$424,778	\$440,790	\$471,864	\$498,071
Debt Service	\$344,497	\$344,497	\$344,497	\$344,497	\$344,497
Debt Service Coverage	1.22X	1.23X	1.28X	1.37X	1.45X
Cash Flow to equity	\$75,450	\$80,282	\$96,293	\$127,367	\$153,574
Equity	\$1,450,000	\$1,450,000	\$1,450,000	\$1,450,000	\$1,450,000
Return on Equity	5.2%	5.5%	6.6%	8.8%	10.6%

A debt coverage ratio (cash flow/annual debt service) of a minimum of 1.2 times is required and 1.4 times is typically preferred by lenders. This analysis shows that the hotel is projected to generate sufficient cash flow to meet its debt service requirements. Also, in this simple analysis, the projected cash on cash return on equity reaches nearly 7 percent in the hotel's third year and reaches nearly 11 percent in the fifth year. These returns are in the range of economic feasibility. To the extent that any financial incentives may be obtained, the viability of the project would be enhanced.

Therefore, under the project cost and terms of financing assumptions used in this analysis, we conclude that the hotel project is economically feasible.

Our financial projections are based on the results of our market study and our analysis of comparable hotel operating data. Some assumptions inevitably will not materialize and unanticipated events and circumstances may occur; therefore, actual results achieved during the period covered by our analysis will vary from our projections and the variations may be material. Further, we are not responsible for future marketing efforts and other management actions upon which actual results will depend.

ADDENDUM

CONSULTANT QUALIFICATIONS HOSPITALITY CONSULTING GROUP

Stephen Sherf – President, Hospitality Consulting Group

Stephen Sherf has over 30 years of consulting experience in the hospitality industry. He spent 15 years with a large national public accounting firm, where he was the partner-in-charge of the hospitality consulting division for the Upper Midwest. He also started a gaming consulting company where he worked for 15 years, and most recently, founded a hospitality consulting company. He is presently active as a sales agent with Minneapolis-based Leines Hotel Advisors.

Mr. Sherf has an extensive background in hospitality consulting that encompasses market studies, valuations, appraisals, acquisitions and sales. He has performed market studies and other advisory services for over 200 hotel projects located mainly throughout the Midwest for clients that include developers, lenders, hotel companies, and municipalities.

He also has particular expertise in development consulting to the gaming industry and has worked on numerous income producing real estate projects that include nursing homes, elderly housing, subsidized and market rate housing, office buildings, retail developments, convention centers, ice arenas, restaurants, convenience stores, bowling alleys and cinemas.

Operating positions held during Mr. Sherf's career include restaurant manager, auditor, Vice President of Development for a hotel company with 13 properties, and Treasurer for a gaming company where he oversaw the operations of three Colorado casinos.

Mr. Sherf is known for his hands-on involvement and realistic conclusions. Where appropriate, development recommendations are backed by an economic feasibility analysis and a sensitivity analysis to assess risk.

He has provided expert witness testimony relating to the valuation of hotels and restaurants and business interruption claims. He has taught continuing education seminars and spoken at gaming, investment, and state appraisal conferences. He has been a guest lecturer at the University of Minnesota Graduate School of Business and Stout University. He is frequently quoted in local newspapers and business magazines.

Mr. Sherf received an undergraduate degree in economics and an MBA in finance from Cornell University. He holds a real estate license in Minnesota and Wisconsin and has taken several American Appraisal Institute courses. He is a Certified Public Accountant (inactive), is active in the Minnesota Lodging Association, has served on the planning commission for the City of Minnetrista, and has held a Colorado gaming license.