

**Hotel Market Analysis
Anchorage, Alaska
October 2005**

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AIDEA

Alaska Industrial Development and Export Authority

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INTRODUCTION

The following report is an update of an earlier study prepared for AIDEA in June 2004 and intended to serve as a baseline document for the purpose of understanding the relative strength or weakness of the local lodging market in Anchorage. The current document has been revised and updated to reflect current economic conditions and performance data for the Anchorage lodging market, culminating in our projections of future lodging market conditions. The data and opinions set forth in this report are based on interviews with state and local officials, hotel owner's, manager's, and developers, and a variety of other direct and indirect participants in the Alaska's tourism industry. The data and opinions set forth in this report are based on our fieldwork and follow-up research conducted during the first three weeks of October 2005.

ECONOMIC OVERVIEW

Demographics

Anchorage occupies an area of 1,955 square miles and is situated on a broad plain at the head of Cook Inlet in the south-central region of the state. Anchorage is Alaska's largest metropolitan area, with an estimated 2004 population of roundly 277,000 persons, constituting roundly 42 percent of the state's total population of approximately 655,000. Population growth in the Borough of Anchorage has averaged 1.0 percent annually between 1995 and 2004, or approximately equal to the population growth rate of the state as a whole. Within the areas of transportation, oil and gas, medical, and financial services, Anchorage serves as the hub for the entire state. Anchorage has also become the center for Alaska's tourism industry, which brings more visitors and money to Anchorage than to any other Alaskan location. Anchorage International Airport is by far the largest single source of visitor arrivals to the state. At its peak in FY2001, Anchorage International Airport served over 5.1 million passengers. Passenger volumes in subsequent years fell to a low of 4,791,000 in FY2003, rebounding slightly to roundly 4,876,000 in FY2004. Due to Anchorage's strategic location, air cargo volumes have demonstrated a compound average annual growth of 7.4 percent since 1995. Recent federal legislation allowing joint international operations could fuel further growth in this industry in the coming years.

The Anchorage economy posted its 16th consecutive year of employment growth in 2004, adding 2,100 new jobs. As shown in Table 1 on the following page, job growth in Anchorage has averaged 2.0 percent annually during the 1995 to 2004 period. While direct comparisons are somewhat limited due to recent changes to the data classification systems, the more significant contributors to growth over this period have been health care, construction, financial services, and leisure and hospitality.

In recent years, health care services has been the single fastest growing industry both in the state and in the Municipality of Anchorage. Growth in the healthcare sector reflects recent expansions at each of Anchorage's major medical facilities including Alaska Psychiatric Institute, Providence Hospital, Alaska Regional Hospital, and Alaska Native Medical Center. The privatization of native healthcare continues to enhance growth throughout this sector. While

much of the growth in healthcare will be concentrated in Anchorage, as it serves as the primary distribution hub for the state, all areas of the state will benefit to some degree from growth in this sector. Future growth in this sector is expected to moderate somewhat from the dramatic growth of recent years.

Table 1						
Anchorage Borough Economic Indicator Summary						
SICS Classification System			NAICS Classification System			
Employment:	1995	2000		2002	2004	CAAGR
Total Nonagricultural	120,500	134,400	Total Non-Farm	140,800	144,400	2.0%
Manufacturing:	2100	2200	Goods Producing	12700	13000	
Construction & Mining	9,100	9,600	Natl. Resource & Mining	2,800	2,100	
Trans./Communications/Utilitie:	12,000	15,000	Construction	8,100	9,200	
Wholesale & Retail Trade	29,700	31,900	Manufacturing	1,800	1,700	
F.I.R.E.	7,200	7,700	Service Providing	128,100	131,400	
Services	32,400	39,200	Trade, Trans. & Utilities	33,100	33,000	
Government	28,100	28,800	Information	4,700	4,400	
			Financial	8,400	9,000	
			Prof. & Business	16,100	16,100	
			Education & Health	16,100	18,400	
			Leisure & Hospitality	14,500	14,700	
			Government	29,600	30,000	
Unemployment Rate:	5.2%	4.8%		5.5%	5.7%	
Population:	1995	2000		2002	2004	CAAGR
State of Alaska	601,646	626,931		640,841	655,435	1.0%
Anchorage	252,876	260,283		268,347	277,498	1.0%
Anchorage International Airpor	1995	2000		2002	2004	CAAGR
Total Air Passengers	4,676,642	5,030,557		4,914,539	4,876,170	0.5%
Cargo Take-off Weights	12,863,000	20,268,769		20,920,586	24,459,763	7.4%
Lodging Tax Reciepts	1995	2000		2002	2004	CAAGR
Anchorage Borough	\$7,185,313	\$10,666,876		\$11,032,882	\$11,601,141	5.5%
Inflation Trends - CPI-U	1995	2000		2002	2004	CAAGR
Anchorage	138.9	150.9		158.2	166.7	2.0%
United States	152.4	172.2		179.9	188.9	2.4%
CAAGR: Compound average annual growth rate						
Sources: Alaska Dept. of Labor; US Census, Anchorage Borough, AIA						

Oil production related employment is still a major driver of the state's resource-based economy, if not a dominant employer. While record oil prices in 2004 peaked at roundly \$39 per barrel, in March 2005 the market saw \$50 per barrel oil prices, followed by \$60 per barrel in early August. Oil prices peaked at roundly \$67 per barrel in late August 2005 and, as of this writing, was hovering slightly over \$60 per barrel. Despite current unusually high oil prices, North Slope employment and exploration work declined in 2003 and again in 2004. Employment in the oil and gas sector is expected to increase modestly in the next several years, barring any major announcements regarding ANWR or the natural gas pipeline. While the state has not seen employment growth in the oil and gas sector in recent years, its short-term fiscal position has benefited dramatically from increased tax revenue generated on higher priced oil. The big items

on the horizon in the oil and gas industry in Alaska continue to be the proposed construction of a natural gas pipeline and potentially opening exploration activities in the Arctic National Wildlife Refuge (ANWR).

- ◆ The prospects for the natural gas pipeline appear more promising today than they did during our prior study. After many months of closed-door negotiations between the state and the major oil and gas companies, a draft contract was presented by the state to producers in early October. If approved by the oil companies, it would be subject to legislative review and a public comment period. Given the current high price of natural gas and diminishing reserves, the viability of this project is quite favorable, while its timing remains highly speculative. While FERC (Federal Energy Regulatory Commission) estimates conservatively anticipate that gas will not flow until 2016, more optimistic estimates suggest construction by 2009, with gas flowing by 2010 or 2011.
- ◆ Similarly, the current outlook for opening ANWR has improved considerably in the last year and, as of this writing, ANWR drilling language has been approved and inserted in the budget reconciliation bill, which is expected to be presented on the senate floor in early November 2005. If approved as drafted, the ANWR language would streamline environmental study requirements and would require legal challenges to be filed within 90-days, all in an effort to expedite this controversial and long awaited project. The federal budget calls for approximately \$2.5 billion in ANWR revenue by 2010. While still far from a certainty, we consider the potential opening of ANWR to be much more likely now than at any time in recent memory.

While we are generally optimistic regarding both of these projects, given their long history and currently indeterminate status, we have not attempted to quantify their potential impact within our analysis. Our interviews suggest that there is a certain level of optimism operating in the market at this time, due in part to the anticipation that one or both of these projects may be moving forward in the near term. While our projections reflect a slightly jaded, but cautious optimism, they are not predicated on either project occurring during our projection period. However, the successful launch of either project would clearly signal the beginning of another major boom period for the economy of Anchorage and the state as a whole.

The tourism sector has a dramatic influence on the economy of Anchorage and the state of Alaska, with the primary drivers being the cruise industry and the lodging industry. Visitor studies completed in recent years indicated summer visitors to the state have increased by over 5.2 percent annually between 2001 and 2004, with approximately 39 percent arriving by cruise ship and 53 percent by air. We suspect that the ratio of cruise ship arrivals will continue to increase as departures from the Seattle market increase. Cruise passenger volumes have grown substantially in recent years as new and larger cruise ships have been regularly added to Alaska waters, including a new ship for Holland America for 2006. The Alaska cruise industry reported roundly 920,000 cruise passengers in 2005, a 5.7 percent increase over 2004 levels. With growth in cruise capacity stabilizing, cruise prices have begun to rebound from the bargain pricing of several years ago, and while the prime demographic remains retired couples traveling together, lower cost itineraries continue to expose younger travelers and families to the benefits

of cruising. Recent operational changes in the market include Princess Tours decision to begin turning their ships in Whittier in 2004, which has successfully enabled them to more efficiently transfer passengers between ship, rail, and plane, and to more efficiently move passengers through Anchorage and on to their wilderness destinations. This improved efficiency has exerted downward pressure on demand for upscale hotels in Anchorage by diverting an increasing share of cruise related demand from the Anchorage market and concentrating it at Princess Tour's recently expanded wilderness lodges.

Denali National Park remains the emotional heart of Alaska's tourism industry and is a dominant component of most land tour packages. Princess expanded both of their hotels in Denali in recent years and are moving forward with a 166-room and 126-room expansion to these properties for 2006. Similarly, Holland America is embarking on a 135-room first phase of a potential 540-room hotel near the entrance to the park, and CIRI has announced their intention to build approximately 250 new rooms in Denali and possibly reinstate their earlier plans to add 100 rooms to their property in Talkeetna. Several years ago each of the major tour operators began offering a multiple-night stay in Denali in response to their guest requests for more time in the natural setting of the park and less time in the city. While much of the increased inventory is intended to meet this increased demand, the bottleneck is in park visitation, which is nearing capacity. In addition, access restrictions within the park will continue to limit the quantity and quality of the Denali experience for many visitors to the state.

Thus far, the 2003 merger of Princess within Carnival Cruise Lines, parent company of Holland America and Cunard Line, has had no significant effect on the market. Both companies continue to operate in largely autonomous fashion and to position themselves as direct competitors. Princess continues to uphold its commitment to developing land-based assets to augment its cruise products, while Holland America, via Westmark Hotels, has seen a renewed commitment to new development and enhancement of its existing statewide lodging portfolio.

Development Activity

Development activity in and around Anchorage continues to be vibrant and active in recent years, a function of low interest rates, massive federal spending, and continued expansion of the local economy. Included in the latest wave of construction were four new hotels which opened in mid 2004, adding 451 new rooms to the market. Since 2002, seven new class-A office buildings have been developed in Anchorage, adding over 600,000 square feet of space to the market. Much of this space has been developed by successful native corporations and several of the larger real estate companies in Anchorage. As owner/users, these groups typically occupy a portion of the space and lease the balance on the open market. According to Bond, Stephens, & Johnson, the vacancy rate in class-A office buildings in the downtown and midtown areas currently stands at a modest 2.9 percent. Other significant projects include the Port of Anchorage's \$350 million expansion in Ship Creek over the next four to six years, a new Home Depot store and two new Wal-Mart super stores, a new medical office building at Providence Hospital, and several large military projects at Fort Richardson and Elmendorf Air Force Base.

On April 5, 2005 Anchorage voters narrowly approved a four-percent increase in the hotel room tax to fund development of a new \$93 million, 193,000 square foot convention center.

According to Anchorage Convention and Visitors Bureau (ACVB), the new center is expected to break ground in spring 2006 and open during the fourth quarter of 2008. The new center will enable the city to host substantially larger groups of up to 5,000 delegates, compared to 1,500 delegates in the existing facility at Egan Center. More importantly, the new facility will enable Anchorage to accommodate multiple events on any given day. Earlier projections for the new convention center estimated it would enable the city to capture approximately 90,000 additional room nights of demand through incremental increases in group sales. In our opinion, the new convention center will be a great asset to the city and it is expected to enhance performance of the local lodging market.

LODGING MARKET ANALYSIS

Anchorage Lodging Market Overview

The Anchorage hotel market is largely concentrated in three geographic areas within the city: the downtown core, the airport area, and the midtown area (south of downtown and northeast of the airport). Of these three areas, the larger, first-class hotels (with the exception of the Millennium) are located in the downtown area, while mid-market hotels are more widely dispersed among all three geographic submarkets. Because the distance between these areas is relatively short (approximately a 10-minute drive), most travelers seeking accommodations in Anchorage typically base their decision on factors other than just geographic location within the city.

For the purpose of our analysis, we defined the Anchorage lodging market into two primary tiers of quality, categorized as upscale and mid-scale. Properties have been classified based on physical attributes, service quality, room pricing, and performance. The table on the following page identifies those properties in each of the two primary tiers, including key physical attributes and current seasonal pricing of guestrooms. Our analysis does not include many of the smaller, older, or independent hotels in the market, nor those in several of the outlying areas.

The upscale lodging market currently consists of five hotels, the Hilton, Sheraton, Captain Cook, and Marriott, each located in the downtown core, and the Millennium Hotel (formerly known as the Regal Alaskan), located near the airport. These hotels range in size from 248 to 606 rooms; collectively, they represent an inventory of 2,168 available guestrooms. The upscale hotels are each full-service facilities, offering one or more restaurant and lounge areas, with meeting and banquet space ranging from 4,700 square feet to over 18,000 square feet. The upscale lodging market has experienced no supply growth in recent years. The latest entrant in this submarket was the 392-room Marriott that opened in April 2000. This was the first new upscale hotel to open in Anchorage since the 1986 opening of the Millennium Hotel. A modest 15-room addition to the Anchorage Hilton was completed in May 2000.

The mid-scale market currently consists of 23 hotels, including four with regional brands, 18 with national brands/franchises, and one independent property. These hotels range in size from 79 rooms to 251 rooms and represent a current inventory of 2,921 available rooms. The size, type, and quality of facilities offered in the mid-scale market are considerably more diverse than in the upscale market. Most hotels in the mid-scale market are limited-service facilities,

although a number of full-service or focused-service hotels are also included. Most of the mid-scale hotels have extremely limited meeting and conference facilities and, as such, are unable to compete aggressively for group related demand. Between 2004 and 2005, four new hotels opened in the mid-scale market and the daily inventory of available rooms increased by 499, representing a nearly 21 percent increase. During the five-year period 2000 through 2005, the daily inventory of available rooms Anchorage's mid-scale market has grown by 46 percent, adding 923 new rooms to the average daily inventory.

Mid-Scale Submarket	Submarket	Open Date	Rooms	F&B	Meeting Space		2005 Room Rates		Amenities
					Total	Largest	AAA/Corp Single/Double		
					Area (SF)	Room	Summer	Winter	
Aspen Hotel	Downtown	2003	89	0/0	1,100	1,100	\$189-\$209	\$109-\$139	ABCDE
Aspen Suites	Midtown	2004	138	0/0	0	0	\$109	\$49-\$69	CDE
Best Western Barratt Inn	Airport	1963-86	217	1/1	2,400	1,400	\$112-\$180	\$59-\$95	CDE
Best Western Golden Lion	Midtown	1977	83	1/1	1,800	952	\$179-\$199	\$89-\$99	CE
Clarion Suites	Downtown	1998	111	1/0	900	900	\$159-\$169	\$75-\$85	ABCDE
Comfort Inn	Downtown	1992	100	0/0	600	600	\$169-\$239	\$79-\$129	ABCDE
Courtyard by Marriott	Airport	1997	154	1/1	2,500	900	\$169	\$89	ABCDE
Days Inn	Downtown	1979-94	130	1/0	575	575	\$79-\$250	\$69-\$125	DE
Dimond Center Hotel	South Anchorage	2002	109	0/0	1,920	1,280	\$229	\$119	CDE
Fairfield Inn & Suites	Midtown	2004	106	0/0	0	0	\$159	\$79-\$89	ABCDE
Hampton Inn	Midtown	1997	101	0/0	300	300	\$179-\$219	\$89-\$109	ABCDEF
Hawthorn Suites, Ltd.	Downtown	1999	111	0/0	3,000	3,000	\$159-\$169	\$79-\$89	ABCDE
Hilton Garden Inn	Midtown	2002	125	1/1	2,100	2,100	\$169-\$309	\$79-\$199	ABCDEF
Howard Johnson Plaza	Downtown	1971	251	1/1	7,000	2,500	\$159	\$69	ACE
Holiday Inn Express	Airport	1999	128	0/0	750	750	\$189-\$199	\$109-\$119	ABDE
Homewood Suites	Midtown	2004	122	0/0	1,728	960	\$229	\$129	ABCDEF
Microtel Inn & Suites	Airport	1997	79	0/0	400	400	\$139-\$149	\$69-\$79	BE
Motel 6	Midtown	2004	85	0/0	0	0	\$139-\$149	\$59-\$64	E
Ramada Inn - Dtn.	Downtown	2003	90	1/1	800	800	\$169-\$239	\$79-\$189	CE
Residence Inn	Midtown	1999	148	0/0	700	700	\$230-\$344	\$129-\$159	ABCDE
Springhill Suites	Midtown	1998	102	0/0	200	200	\$179-\$199	\$89	ABCDE
Westmark Hotel	Downtown	1970	200	1/1	5,750	3,700	\$219	\$109	CF
Coast International Inn	Airport	1973	142	1/1	5,700	3,700	\$149-\$169	\$71-\$91	CE
Subtotal			2,921		40,223				
Upscale Submarket									
Anchorage Hilton	Downtown	1958-84	606	3/2	18,088	7,680	\$169-\$309	\$79-\$199	ABCDEF
Hotel Captain Cook	Downtown	1965	547	4/4	18,053	9,045	\$245-\$285	\$145 - \$185	ABCDEF
Marriott Hotel Anchorage	Downtown	2000	392	1/1	10,309	8,122	\$269-\$289	\$149	ABCDEF
Millennium Hotel	Airport	1986	248	1/1	4,655	2,685	\$260-\$290	\$150-\$180	BCDEF
Sheraton Hotel	Downtown	1979	375	2/2	15,730	9,395	\$279	\$169	BCDEF
Subtotal			2,168		66,835				
TOTAL			5,089		107,058				
							Amenities	A Pool	D Bus. Ctr.
								B Spa	E Gst Ldry.
								C Exercise	F Retail

Source: K&M interviews, phone survey, AAA-2005, individual websites

In analyzing the Anchorage lodging market, we acknowledge the qualitative and competitive differences between properties in the upscale and mid-scale markets. However, we also acknowledge that seasonal variations in demand patterns create major changes in rooms pricing within the market, which tends to blur the traditional lines of competition among properties during off-season periods. While Anchorage has always struggled with this issue, it has become increasingly significant in recent years due to heightened competition resulting from supply

increases and increased usage of more heavily discounted Internet marketing alternatives. It is important to recognize that the local lodging market is very dynamic and no hotel operates in a vacuum, but rather, changes in the larger competitive environment can and will impact performance levels for all properties in the market.

Historical Supply and Demand

Table 3, presented on page 9, summarizes information regarding the historical operating performance of the competitive hotels in Anchorage's mid-scale and upscale markets for the period 2000 through 2005. Key indications from this summary are as follows:

- ◆ 2004 and 2005 have generally been good years for the Anchorage lodging market, with overall market occupancies increasing three percentage points to 70 percent from their recent low of 67 percent in 2003. During this period, rooms demand grew by over 15 percent, exceeding the nearly 11 percent growth in the available rooms supply during this period. The upscale and mid-scale submarkets each showed improved occupancies during these years, with the upscale submarket largely recapturing much of its earlier decline. Although the mid-scale submarket improved by two to three occupancy points, its solid improvement is masked somewhat by the recent increases in the rooms supply.
- ◆ During the 2000 to 2005 period, the available room supply in the overall market averaged 4.6 percent compounded annually. However, the vast majority of this supply change occurred in the mid-scale submarket, which posted average supply growth during this period of 7.9 percent annually. Despite the comparatively high rate of supply growth during this period, demand growth generally kept pace within both submarkets, yielding very similar occupancies at the beginning and end of this five-year period. Overall, the strength and resilience demonstrated by the market during this period is quite remarkable.
- ◆ The local market has benefited in recent years from strong performance across all demand segments. Growth in corporate and government demand reflects the groundswell of expansion in the local economy as well as the broad reach of Anchorage firms across the state. The group demand segment has been bolstered by ACVB's ability to deliver solid convention volumes in both 2004 and 2005. The outlook for 2006 and 2007 is expected to mirror the solid booking pace of recent years. The leisure travel segment showed measured growth and stability in recent years, despite fundamental shifts in usage patterns. The contract demand segment continues to grow, largely fueled by the cargo carriers. While this demand continues to shift between various hotels in search of the optimal combination of price and facilities, it is considered a stabilizing force in the market.
- ◆ While the market clearly skipped a beat in 2003, leading us to believe that it was approaching saturation, performance in 2004 and 2005 has allayed these fears and demonstrated the market's continued ability to absorb new supply.

- ◆ The decline in demand patterns that began to appear in the upscale segment in 2003 and was attributed to diversion of demand to Denali, appears to have faded somewhat in recent years. While Princess continues to internalize demand at its owned lodges and to drive efficiency by turning its ships in Whittier, the resulting decline in Anchorage hotel demand is diminishing and is being offset by growth in passenger volumes. While continued expansion of the rooms inventory in Denali could continue to draw off demand from Anchorage, we expect this trend is beginning to stabilize.
- ◆ While the overall market occupancy for Anchorage is hovering at roundly 70 percent for 2004 and estimated year-end 2005, this still compares quite favorably to the 2004 U.S. national average occupancy rate of 61.3 percent, as indicated by Smith Travel Research.
- ◆ The average room rate of a hotel is calculated by dividing total room revenue by total occupied room nights and it reflects the net impact of all forms of discounting. Average room rates (ARR) within the overall market began to show modest decline in 2002 falling nearly three percent from \$116 to \$113 and then falling an additional four percent in 2003, as the overall average room rate declined from \$113 to \$108. Despite the addition of more rooms to the mid-scale submarket between 2004 and 2005, the overall market average room rate has been sustained at the \$108 level.
- ◆ The recent decline in average room rates have been more heavily weighted to the upscale properties, which lost \$7 in average room rate between 2000 and 2005, compared to the mid-scale properties, where the average room rate has declined by only \$2. Greater rate erosion in the upscale market continues to reflect the effects of increased competition from the better-quality properties opening in the mid-scale submarket, several of which have surpassed the average room rate of the lower-end, upscale facilities. Rate erosion continues to be influenced by increased use of the Internet by guests and the proliferation of web portals offering discounted room rates. While there has been an aggressive effort by the hotel community to regain control of room rates on the Internet, this issue continues to exert downward pressure on room rates in the market, especially during off-peak periods.
- ◆ Revenue per available room (RevPAR) reflects the relationship between occupancy and average room rate, and is generally considered a reliable basis for comparing the revenue generating ability of hotels. The combined effects of vacillating occupancy rates and slow deterioration in average room rates yielded a decline in RevPAR for the overall market from \$80 in 2000 to roundly \$75 in 2005. The bulk of this decline has resulted from changes in rate and/or occupancy in the upscale submarket, largely due to rate erosion. In contrast, the mid-scale submarket saw RevPAR increase during the 2000 to 2002 period, although this growth was quickly eroded in 2003, followed by only modest improvement in recent years.

Table 3
Competitive Lodging Market Overview - 2000 through 2005
Anchorage, Alaska

	Available Rooms		Fair Share	Occ. Rate	Occupied Rm. Nights	Market Share	Penetr'n Rate	Average Rm. Rate	Room Revenue		REVPAR Index
	Daily	Annually							Total	Per Rm.	
Est. 2005											
Mid-Scale Submarket	2,921	1,066,165	57.4%	73%	778,940	60.3%	105.0%	\$96.00	\$74,930,661	\$70.00	93.3%
Upscale Submarket	2,168	791,320	42.6%	65%	513,293	39.7%	93.2%	\$126.00	\$64,815,431	\$82.00	109.3%
Total Market	5,089	1,857,485	100.0%	70%	1,292,232	100.0%	100.0%	\$108.00	\$139,746,092	\$75.00	100.0%
% chg.		5.6%			4.5%				4.6%	-1.3%	
2004											
Mid-Scale Submarket	2,649	966,899	55.0%	74%	712,242	57.6%	104.7%	\$95.00	\$67,800,025	\$70.00	92.1%
Upscale Submarket	2,168	791,320	45.0%	66%	524,764	42.4%	94.3%	\$125.00	\$65,796,057	\$83.00	109.2%
Total Market	4,817	1,758,219	100.0%	70%	1,237,007	100.0%	100.0%	\$108.00	\$133,596,083	\$76.00	100.0%
% chg.		4.9%			10.1%				9.7%	4.1%	
2003											
Mid-Scale Submarket	2,422	884,203	52.8%	71%	631,500	56.2%	106.5%	\$96.00	\$60,380,000	\$68.00	93.2%
Upscale Submarket	2,168	791,320	47.2%	62%	492,459	43.8%	92.8%	\$125.00	\$61,384,545	\$78.00	106.8%
Total Market	4,590	1,675,523	100.0%	67%	1,123,959	100.0%	100.0%	\$108.00	\$121,764,544	\$73.00	100.0%
% chg.		6.1%			-1.0%				-5.1%	-9.9%	
2002											
Mid-Scale Submarket	2,159	787,941	49.9%	78%	611,635	53.9%	108.0%	\$98.00	\$60,148,000	\$76.00	93.8%
Upscale Submarket	2,168	791,320	50.1%	66%	523,368	46.1%	92.0%	\$130.00	\$68,192,000	\$86.00	106.2%
Total Market	4,327	1,579,261	100.0%	72%	1,135,003	100.0%	100.0%	\$113.00	\$128,340,000	\$81.00	100.0%
% chg.		3.8%			5.5%				3.2%	-1.2%	
2001											
Mid-Scale Submarket	2,002	730,730	48.0%	76%	555,495	51.6%	107.6%	\$99.00	\$55,054,000	\$75.00	91.5%
Upscale Submarket	2,168	791,320	52.0%	66%	520,329	48.4%	93.0%	\$133.00	\$69,255,000	\$88.00	107.3%
Total Market	4,170	1,522,050	100.0%	71%	1,075,823	100.0%	100.0%	\$116.00	\$124,309,000	\$82.00	100.0%
% chg.		2.6%			4.3%				4.7%	2.5%	
2000											
Mid-Scale Submarket	1,998	729,270	49.2%	73%	530,535	51.5%	104.7%	\$98.00	\$52,021,000	\$71.00	88.8%
Upscale Submarket	2,066	754,240	50.8%	66%	500,520	48.5%	95.5%	\$133.00	\$66,701,000	\$88.00	110.0%
Total Market	4,064	1,483,510	100.0%	70%	1,031,055	100.0%	100.0%	\$115.00	\$118,722,000	\$80.00	100.0%
% chg.		11.7%			9.2%				9.7%	-2.4%	
Compound Average Annual Growth Rate 2000 - 2005											
Mid-Scale Submarket	7.9%	7.9%			8.0%			-0.4%	7.6%	-0.3%	
Upscale Submarket	1.0%	1.0%			0.5%			-1.1%	-0.6%	-1.4%	
Total Market	4.6%	4.6%			4.6%			-1.2%	3.3%	-1.3%	

Source: Kennedy & Mohn, P.S.

Seasonal Factors

The Anchorage lodging market is highly seasonal, with market-wide occupancy levels historically averaging greater than 85 percent from June through early September. During much of this period, the better-quality properties in the market typically run at, or near, practical capacity levels. Conversely, occupancy levels during off-peak periods typically fall to the mid-30 to mid-40 percent range especially during December and January, normally the slowest months of the year. Seasonal demand patterns in Anchorage have moderated somewhat in recent years, as a result of the increase in the available room supply, making more rooms available to meet peak season demands, and also heightening competition for the limited base of demand during off-peak periods. In the mid to late 1990's, peak season typically ran from May 15th to September 15th, whereas recent interviews suggest this peak now begins in early June and lasts

until the beginning of September. Given the significant seasonal swings in demand, hotels in the market have historically used a two-tiered seasonal rate structure, with off-peak advertised room rates typically half the peak season rates. The combined effect of seasonal changes in room rates and demand patterns are visible in the historical trends in hotel room tax receipts reported by the Municipality of Anchorage, as shown in the following table.

Table 4						
Anchorage Hotel Motel Tax Receipts - 1998 - 2005						
	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Total	% Chg.
1998	1,163,340	2,829,037	4,352,789	1,450,577	9,795,743	
1999	1,162,874	2,847,487	4,570,379	1,455,966	10,036,706	2.5%
2000	1,319,719	3,093,761	4,725,604	1,527,792	10,666,876	6.3%
2001	1,568,775	3,236,785	4,749,463	1,572,033	11,127,056	4.3%
2002	1,510,734	3,225,205	4,540,122	1,756,821	11,032,882	-0.8%
2003	1,381,000	2,924,934	4,339,020	1,571,670	10,216,624	-7.4%
2004	1,501,222	3,340,719	5,044,822	1,714,378	11,601,141	13.6%
2005	1,523,742	3,336,163	<i>12-Mo. Ended 2nd Qtr 2005</i>		<i>11,619,105</i>	0.2%
2004 % of Annual	13%	29%	43%	15%	100%	
CAAGR 1998-2004	4.3%	2.8%	2.5%	2.8%	2.9%	
* Data shown for period earned, not when remitted for collection.						
Source: MOA Finance Department - Hotel Bed Tax Receipts						

Peak season demand is predominantly leisure related and is heavily influenced by the major cruise lines and smaller tour operators, with much of their demand concentrated in the larger, first-class hotels in the downtown core. This demand has traditionally paid a premium for rooms due to limited availability of appropriate quality facilities, although with increasingly lower cost cruise prices in recent years, downward pressure on hotel rates has been significant and fewer cruise rooms are being overnighed in the market.

During much of the 1990's, convention related demand was largely excluded from Anchorage from May through September due to lack of available rooms and inflexible, premium pricing structures. With the substantial increase in the available rooms supply in the market in recent years and declining occupancies at the larger hotels, most of the major hotels downtown have become much more aggressive at marketing to small and mid-sized conventions and groups during much of the summer season. The Anchorage Convention and Visitors Bureau began marketing summer season to small groups several years ago and has since expanded their marketing to groups of 400 to 500 delegates. The market now benefits regularly from summer season group demand. According to ACVB, convention and group demand patterns were quite strong in 2004 and 2005 and are expected to remain at this level for 2006 and 2007, excepting minor rotational influences. The AFN (Alaska Federation of Natives) conference was moved to Fairbanks in 2005 and initial indications are that it went smoothly. While we understand the vote from the floor indicated support for keeping the convention in Fairbanks in future years, a formal decision on this matter isn't expected to be made until later this year. We anticipate AFN will elect to rotate the convention between Anchorage and Fairbanks in future years.

Segmentation

We classified market demand into four general categories: commercial, leisure, group, and contracts. Segmentation data is routinely tracked by hotel operators, although the level of detail and accuracy of the data varies widely between properties. In recent years it has become more and more difficult for hotel operators to maintain accurate segmentation data due to the increased use of Internet booking engines and promotions. While these choices can be attractive to the guest, they hinder the hotel's ability to accurately track guest segmentation patterns.

Commercial demand is composed of independent business travelers and state and federal government workers. Based on our recent interviews, we estimate this demand represents approximately 42 percent of total demand in the overall market, consistent with our prior study. This demand is reasonably stable throughout the year, with modest declines during summer and holiday periods.

Leisure demand represents approximately 32 percent of total demand in the market for 2005. Demand in this segment consists of independent and packaged leisure travelers, who often come through Anchorage en-route to other areas of the state. The packaged leisure or tour and travel component of this demand, which is heavily cruise oriented, is concentrated almost exclusively within the peak summer season. Cruise related demand is provided by Princess Cruises, Holland America Lines, and Royal Caribbean Cruises, among others. Due to ocean conditions in the Gulf of Alaska in the spring and fall, further expansion of the peak season window is not expected. However, growth in cruise related demand in recent years has resulted from the addition of newer and larger ships to the Alaska market. According to CLIA, (Cruise Lines International Association), cruise capacity in Alaska has increased on average 10.4 percent annually between 2003 and 2005.

Group demand consists of conventions and meeting related travel to Anchorage, and demand generated by sports teams and school events. Currently, group demand represents approximately 13 percent of total demand in the market. Demand in this segment is typically concentrated during shoulder periods in the spring and fall, although in recent years we have seen increased summer season group activity.

Contract demand is provided primarily by passenger and cargo airlines serving Anchorage. In 2005, contract demand made up the remaining 13 percent of total demand in the market. While the ratio of demand in this segment has been relatively flat since 1995, the total volume of demand has grown substantially. Contract demand in Anchorage has historically paid premium rates, due in part to the seasonal timing of demand coinciding with seasonal capacities in the market. However, as the available rooms supply increased and better quality mid-market alternatives became available, rates in this segment have begun to soften. Much of the growth in demand in this segment in recent years has come from the contract airlines and from TSA staff brought in during peak summer months to provide airport security.

SUPPLY AND DEMAND PROJECTIONS

In evaluating the performance potential of the Anchorage lodging market, it is necessary to understand historical and projected changes in the competitive rooms supply and anticipated changes in market demand volumes and patterns over the near to mid-term. Our analysis incorporates new hotels expected to open in the next several years. Projections of growth in future demand reflect contributions from three fundamental sources: unsatisfied demand, induced demand, and underlying growth in demand. A detailed discussion of our analysis is presented in the following paragraphs.

Supply Changes

As shown in Table 5 below, there are four hotel projects currently proposed for development in Anchorage that will impact the performance of the lodging market in future years. While several of these projects are still in their preliminary stages, with site and size factors still in flux, our interviews suggest that these projects could collectively represent approximately 545 new rooms entering the market during the next 18 months.

<u>Property</u>	<u>Quality</u>	<u>Type</u>	<u>Location</u>	<u># Rooms</u>	<u>Opening</u>
<u>Mid-market</u>					
Embassy Suites	Upscale	Transient	Mid-town	135	Apr-07
Holiday Inn	Mid-scale	Transient	Mid-town	160	Jun-07
ANMC	Mid-scale	Transient	Mid-town	N/A	N/A
Comfort Suites	Mid-scale	Transient	Airport	N/A	N/A
Source: K&M - Oct 2005					

In addition, there are two other hotel developments or expansion projects currently being discussed, that could potentially add over 250 more rooms to the market in 2008. For a variety of reasons, we consider these project's too preliminary to warrant inclusion in our projections at this time, but they will be considered in our long-range outlook on the market. As of this writing, there are no major hotel projects being discussed to coincide with the new convention center. While in our opinion, such a project would be premature at the present time, the opportunity and merit of such a project will likely be enhanced near the end of this decade as the new center begins to successfully attract more and larger groups and conventions to the Anchorage market.

As in our prior report, one of the more interesting facets of the projects presented above is that most, but not all, of the proposed hotels are being developed by parties that know the Anchorage market intimately, have multiple other hotels in the market, and are fully aware of the volume of other new projects in the pipeline. This suggests that presumably knowledgeable developers continue to have a high degree of confidence in the long-term strength of the Anchorage lodging market.

Anchorage Convention Center Expansion

Since 1997, Anchorage has been pursuing development of a new or expanded convention center to better enable the city to attract larger groups, to accommodate existing groups that have out-grown Egan Center, and to allow hosting of multiple events simultaneously. In April 2005 Anchorage voters approved an increase in the hotel/motel bed tax from 8 to 12 percent to pay for a \$93 million expansion to convention facilities. The expanded civic and convention center complex will link existing facilities at the Egan Center and the Alaska Center for the Performing Arts to a 190,000-square-foot addition that includes a 50,000 square-foot exhibit hall, a ballroom and meeting rooms. Special purpose revenue bonds will be sold on the open market, starting in November 2005 to pay back the bonds and will be used for operations and maintenance of an expanded civic and convention center complex. The new facility is expected to break ground in Spring 2006 and open 4th quarter 2008. While this project narrowly passed the public vote, it has had broad based support within Anchorage's hotel community. Earlier projections by convention center planners indicated that an expanded convention center complex would generate approximately 90,000 room nights of incremental lodging demand. According to officials at ACVB, there have been no recent updates to these earlier projections.

Demand Changes

Within our analysis, projections of growth in demand reflect the combination of three individual components including unsatisfied demand, underlying growth, and induced demand.

- ◆ Unsatisfied demand is that component of new demand that can be accommodated in the market as new hotel rooms open, thereby providing additional capacity during peak periods.
- ◆ Underlying growth is projected based on the strength of local and regional economic indicators such as growth in population, employment, growth in room tax collections, and growth in air travel.
- ◆ Induced demand reflects changes in the market that result from forces external to the market. Induced demand can be either positive or negative. The opening of a new demand generator within the market might provide a positive inducement of demand, while the opening of competing hotels outside the competitive market, which draws off demand, would result in negative induced demand.

In arriving at our estimates of future demand growth, consideration was given to the mix of demand by segment, seasonal patterns of demand, and the seasonal capacity within the expanding market. Additionally, because of disproportionate growth in the mid-scale market and the resulting transfer of demand between the upscale and mid-scale submarkets, we projected future growth for both submarkets and the overall market. Key factors in our analysis are summarized in the following paragraphs.

- ◆ Unsatisfied demand is projected based on estimates from managers in the market, which suggest that historically there were between 90 and 120 nights annually when the market filled to capacity and demand was turned away or otherwise unaccommodated. Our

interviews suggest that the number of fill nights in the market has been declining in recent years but has rebounded somewhat from the low of roundly 60 fill nights indicated in our prior study. Current interviews suggest that the market experienced on average, approximately 75 fill nights during 2005 and a similar amount in 2004. The experience of individual hotels may vary widely, depending on size, quality, location, and other factors. Recent trends indicate that fill nights in the market now tend to occur later, meaning the properties just barely fill, rather than filling several weeks out, as in previous years. Our projections include approximately 75 nights of new demand added to the market for each new room opened in 2007 and 2008.

- ◆ Consistent with our prior analysis, our projections include the infusion of roundly 60,000 room nights of induced demand captured in the market as a result of the presumed opening of the expanded convention center in late 2008. This demand is allocated to the group segment and is presumed to be primarily captured by the larger group hotels in the upscale submarket. Because the convention center expansion is projected to open late in our projection period, we have only induced approximately 65 percent of the total 90,000 room nights of demand originally estimated to be generated by this project. Additional demand induced into the market would be expected to be captured in later years, beyond our projection period.

Our projections also include approximately 5,000 room nights of negative induced demand that is expected to be drawn away from the market by the continued consolidation of cruise/tour demand to the better quality wilderness lodge facilities in outlying areas. This demand is extracted from the upscale submarket in 2006.

Based on historical results in the market, we estimated underlying growth in demand within the market based on the relative strength of the Anchorage economy as reflected in part by growth in employment, air passenger and cargo volumes, cruise passenger growth, and recent growth in room tax collections, which generally support underlying growth rates ranging from 1.0 to 5.5 percent. Our projections of demand growth by segment are shown in Table 6 on the following page.

- ◆ We project underlying growth in demand of 4.0 percent annually in the commercial segment, applied uniformly throughout the projection period. This growth rate reflects a base rate of roundly three percent and a premium of one percent, which is attributed to the current dynamic qualities of the Anchorage economy, which we believe are influenced to some degree by optimism surrounding the potential for development of ANWR and/or the natural gas pipeline.
- ◆ Within the group demand segment, growth is projected at 2.0 annually in 2006 through 2008, based on solid bookings in place for the next several years. In the later years of our projection period, a slightly higher growth rate of 3.0 percent is applied, reflecting the enhanced ability to sell Anchorage to groups as a result of the expanded center.

Table 6						
Projected Demand Growth by Segment						
Mid-Scale Market	2006	2007	2008	2009	2010	Mix
Commercial Demand	362,900	387,000	408,300	424,600	441,600	46%
Underlying Growth	4.0%	4.0%	4.0%	4.0%	4.0%	
Unsatisfied Demand	0	9,600	5,800	0	0	
Induced Demand	0	0	0	0	0	
Group Demand	70,100	71,500	72,900	77,600	87,400	9%
Underlying Growth	2.0%	2.0%	2.0%	3.0%	3.0%	
Unsatisfied Demand	0	0	0	0	0	
Induced Demand	0	0	0	2,500	7,500	
Leisure Demand	300,800	319,400	334,800	344,800	355,100	37%
Underlying Growth	3.0%	3.0%	3.0%	3.0%	3.0%	
Unsatisfied Demand	0	9,600	5,800	0	0	
Induced Demand	0	0	0	0	0	
Contract Demand	70,000	70,700	71,400	72,100	72,800	8%
Underlying Growth	1.0%	1.0%	1.0%	1.0%	1.0%	
Unsatisfied Demand	0	0	0	0	0	
Induced Demand	0	0	0	0	0	
Total Demand	804,000	849,000	887,000	919,000	957,000	100%
Upscale Market						Mix
Commercial Demand	205,900	215,800	224,900	233,900	243,300	38%
Underlying Growth	4.0%	4.0%	4.0%	4.0%	4.0%	
Unsatisfied Demand	0	1,700	500	0	0	
Induced Demand	0	0	0	0	0	
Group Demand	103,800	107,600	110,300	123,600	167,300	26%
Underlying Growth	2.0%	2.0%	2.0%	3.0%	3.0%	
Unsatisfied Demand	0	1,700	500	0	0	
Induced Demand	0	0	0	10,000	40,000	
Leisure Demand	111,800	116,900	120,900	124,500	128,200	20%
Underlying Growth	3.0%	3.0%	3.0%	3.0%	3.0%	
Unsatisfied Demand	0	1,700	500	0	0	
Induced Demand	(5,000)	0	0	0	0	
Contract Demand	101,100	102,100	103,100	104,100	105,100	16%
Underlying Growth	1.0%	1.0%	1.0%	1.0%	1.0%	
Unsatisfied Demand	0	0	0	0	0	
Induced Demand	0	0	0	0	0	
Total Demand	523,000	542,000	559,000	586,000	644,000	100%
Overall Market						
Commercial Demand	43%	43%	44%	44%	43%	
Group Demand	13%	13%	13%	13%	16%	
Leisure Demand	31%	31%	31%	31%	30%	
Contract Demand	13%	12%	12%	12%	11%	
Total Demand	100%	100%	100%	100%	100%	

- ◆ We project demand growth in the leisure segment of 3.0 percent annually throughout the projection period, based on historical growth in room tax collections and a favorable outlook for cruise/tour volumes in the near term.

- ◆ Underlying growth in the contract demand segment is projected at 1.0 annually throughout the projection period.

Table 7 presented on the following page incorporates our individual projections of demand growth by segment and submarket into a single presentation of historical and projected changes in supply and demand within the Anchorage market. Collectively, our estimates of unsatisfied, induced, and underlying demand growth indicate a 4.8 percent average annual increase in demand for the overall market from 2006 through 2010. This rate of growth in demand is greater than the 3.7 percent rate projected in our prior study and it reflects the strong rebound in performance achieved by the market in 2004 and 2005, combined with continued supply increases, now certainty in the convention center project, and greater likelihood of one or more of the large oil and gas projects moving forward. Our current projections are only slightly greater than the 4.6 percent growth in demand actually achieved by the market during the 2000 to 2005 period, which was negatively influenced by several factors. Overall, based on the available data, we consider this projection of future growth in supply and demand within the market to be reasonable and well supported

Based on this analysis, our projections of future market conditions in the mid-scale submarket indicate that occupancy rates will improve in 2006 to approximately 75 percent, before falling to 73 percent in 2007 and 2008 as a result of a sizeable increase of new rooms entering the market. With continued expansion in all demand segments, occupancies in the mid-scale submarket are projected to reach 76 percent in 2009 and 79 percent in 2010 as the benefit of the expanded convention center is reflected in the market. Similarly, within the upscale sub market, occupancies are projected to improve slightly in 2006 reaching 66 percent, falling to 65 percent in 2007, with the opening of the Embassy Suites. Growth in later years is heavily influenced by new demand expected to be generated by the convention center expansion, which is projected to drive occupancies in the upscale submarket in excess of 70 percent in 2009 and 77 percent in 2010, assuming no other hotel projects are developed. Anchorage's upscale market has not seen occupancies in the mid-70 percent range since the mid-1990's. The blending of these two submarkets indicates overall market occupancies remaining at or about their current levels through 2008, with significant improvement coming in the last two years of the projection period, following the opening of the expanded convention center. These projections are based on the assumption that no additional rooms are added to the market after the roundly 545 new rooms open in 2007 and 2008. In the event growth in market occupancies follows our projections in the near term, it is highly likely that one or more as yet unidentified new hotels could enter the market in 2009 or 2010, thereby holding down market occupancies somewhat from the levels shown in our projections.

Table 7 Historical and Projected Market Conditions										
Historical Market Conditions				Projected Market Conditions						
2002	2003	2004	2005		2006	2007	2008	2009	2010	
				Mid-Scale Market						
2,159	2,422	2,649	2,921	Existing Product	2,921	2,921	2,921	2,921	2,921	
				Holiday Inn	0	80	160	160	160	
				ANMC Hotel	0	100	100	100	100	
				Other	0	75	150	150	150	
2,159	2,422	2,649	2,921	Average Daily Rooms	2,921	3,176	3,331	3,331	3,331	
787,941	884,203	966,899	1,066,165	Annual Room Nights	1,066,165	1,159,240	1,215,815	1,215,815	1,215,815	
7.8%	12.2%	9.4%	10.3%	Percentage Change	0.0%	8.7%	4.9%	0.0%	0.0%	
611,635	631,500	712,242	778,940	Market Demand	804,000	849,000	887,000	919,000	957,000	
CAAGR	Supply chg.	10.6%			CAAGR	Supply chg.	3.3%			
CAAGR	Demand chg.	8.4%			CAAGR	Demand chg.	4.5%			
56,140	19,865	80,743	66,697	Change from prior year	25,060	45,000	38,000	32,000	38,000	
10.1%	3.2%	12.8%	9.4%	Percentage Change						
(14,107)	(15,824)	(16,992)	(20,397)	Unsatisfied Demand	0	19,125	11,625	0	0	
0	0	0	0	Induced Demand	0	0	0	2,500	7,500	
42,034	4,041	63,751	46,300	Underlying Growth	25,060	25,875	26,375	29,500	30,500	
8%	1%	10%	7%	Underlying Growth Rate	3.2%	3.2%	3.1%	3.3%	3.3%	
78%	71%	74%	73%	Occupancy	75%	73%	73%	76%	79%	
				Upscale Market						
2,168	2,168	2,168	2,168	Existing Product	2,168	2,168	2,168	2,168	2,168	
				Embassy Suites	0	102	135	135	135	
					0	0	0	0	0	
2,168	2,168	2,168	2,168	Average Daily Rooms	2,168	2,270	2,303	2,303	2,303	
791,320	791,320	791,320	791,320	Annual Room Nights	791,320	828,445	840,595	840,595	840,595	
0.0%	0.0%	0.0%	0.0%	Percentage Change	0.0%	4.7%	1.5%	0.0%	0.0%	
523,368	492,459	524,764	513,293	Market Demand	523,000	542,000	559,000	586,000	644,000	
CAAGR	Supply chg.	0.0%			CAAGR	Supply chg.	1.5%			
CAAGR	Demand chg.	-0.6%			CAAGR	Demand chg.	5.3%			
3,040	(30,909)	32,305	(11,472)	Change from prior year	9,707	19,000	17,000	27,000	58,000	
0.6%	-5.9%	6.6%	-2.2%	Percentage Change						
0	0	0	0	Unsatisfied Demand	0	5,086	1,664	0	0	
0	0	0	0	Induced Demand	(5,000)	0	0	10,000	40,000	
3,040	(30,909)	32,305	(11,472)	Underlying Growth	14,707	13,914	15,336	17,000	18,000	
1%	-6%	7%	-2%	Underlying Growth Rate	2.9%	2.7%	2.8%	3.0%	3.1%	
66%	62%	66%	65%	Occupancy	66%	65%	67%	70%	77%	
				Overall Market						
4,327	4,590	4,817	5,089	Average Daily Rooms	5,089	5,446	5,634	5,634	5,634	
1,579,261	1,675,523	1,758,219	1,857,485	Overall Market Supply	1,857,485	1,987,685	2,056,410	2,056,410	2,056,410	
4%	6%	5%	6%	Supply Growth	0%	7%	3%	0%	0%	
1,135,003	1,123,959	1,237,007	1,292,232	Overall Market Demand	1,327,000	1,391,000	1,446,000	1,505,000	1,601,000	
6%	-1%	10%	4%	Demand Growth	3%	5%	4%	4%	6%	
CAAGR	Supply chg.	5.6%			CAAGR	Supply chg.	2.6%			
CAAGR	Demand chg.	4.4%			CAAGR	Demand chg.	4.8%			
72%	67%	70%	70%	Occupancy	71%	70%	70%	73%	78%	

Source: Kennedy & Mohn, P.S.

Average Room Rates

The only thing certain about average room rates is that they are constantly in a state of flux. The direction of change and the relative significance of the change depend on a myriad of forces operating within the market and the response to these forces by the individual operators. Looking strictly at the data, we see that during the period 2000 through 2005, average room rates in the Anchorage market showed a 1.2 percent average annual decline. In contrast, the last time

the Anchorage market as a whole experienced average room rate growth, at or near the underlying rate of inflation, was in the mid to late 1990's. While many of the individual hotels are in fact achieving growth in average room rates at or near the rate of inflation, many properties are not. Clearly rate growth can substantially exceed inflation if conditions are right, as evidenced during the 1997 to 1999 period when we saw average room rates in the mid-scale submarket increase by 4.0 to 8.0 percent annually. However, as recent experience would show, rate growth can also be negative when certain conditions converge against the market. The proliferation of Internet booking services in recent years is one of the factors that has contributed to rate erosion and lack of rate control by individual hotel operators. Similarly, an operator who attempts to buy demand by reducing room rates quickly finds that this strategy rarely generates any additional demand in a market, but rather reallocates existing market demand at a lower cost to the end user. This type of market response is likely at the root of the modest declines in average room rates that occurred in the market in 2002 and 2003, when a fear of reduced demand levels drove average room rates down without yielding any significant benefit by attracting more demand. While average room rates show no significant decline in 2004 and 2005, growth in rate was stifled by budget orientation of 223 of the 451 new rooms that entered the market recently. Clearly these rooms were competing at the bottom of the then current rate hierarchy in the market.

To derive a five-year projection of average room rate, we considered the dual impacts of inflation and anticipated market conditions. We have incorporated an underlying inflation rate of 2.5 percent annually throughout the projection period. Market condition adjustments are based on our estimates of how the market will respond to a variety of factors including, the addition of new rooms in future years, the type and quality of new rooms entering the market, continued shifts in cruise/tour demand, increased levels of potentially lower-rated group demand following the opening of the proposed convention center, and future responses to rate erosion by the Internet and discounting practices by operators.

Our projections reflect a period of renewed rate growth in 2006 as properties position themselves more aggressively during a period of no new supply. Rate growth is projected to go flat again in 2007 and 2008 as the market responds to, and slowly absorbs, the new wave of supply. In 2009, we project inflationary growth in rate in the mid-scale submarket and slightly less in the upscale submarket, reflecting downward pressure from larger contributions of discounted group demand. Modest increases in these levels are projected for 2010. Our projections indicate a 1.4 percent compound average annual growth in room rates over the five-year projection period. This projection is considerably more optimistic than the 1.3 percent average annual decline achieved during the 2000 to 2005 period, but only one half the rate achieved during the 1995 to 1999 period. Our projections of growth in average room rate for each submarket are shown in the table on the following page. The resulting average room rate for the overall market is the weighted average reflecting demand patterns and rates within the two submarkets.

Table 8						
Projected Average Room Rate And Revenue Per Available Room						
<u>Year/Market</u>	<u>Inflation</u>	<u>Market Response</u>	<u>Total Change</u>	<u>Projected ARR</u>	<u>Projected Occup. %</u>	<u>Projected REVPAR</u>
2005						
Midscale Submarket				\$96.00	73%	\$70.14
Upscale Submarket				\$126.00	65%	\$81.73
Overall Market				\$108.00	70%	\$75.13
2006						
Midscale Submarket	2.50%	0.00%	2.50%	\$98.00	75%	\$73.90
Upscale Submarket	2.50%	0.00%	2.50%	\$129.00	66%	\$85.26
Overall Market				\$110.00	71%	\$78.58
2007						
Midscale Submarket	2.50%	-2.50%	0.00%	\$98.00	73%	\$71.77
Upscale Submarket	2.50%	-2.50%	0.00%	\$129.00	65%	\$84.40
Overall Market				\$110.00	70%	\$76.98
2008						
Midscale Submarket	2.50%	-2.50%	0.00%	\$98.00	73%	\$71.50
Upscale Submarket	2.50%	-2.50%	0.00%	\$129.00	67%	\$85.79
Overall Market				\$110.00	70%	\$77.35
2009						
Midscale Submarket	2.50%	0.00%	2.50%	\$100.00	76%	\$75.59
Upscale Submarket	2.50%	-1.00%	1.50%	\$131.00	70%	\$91.32
Overall Market				\$112.00	73%	\$81.97
2010						
Midscale Submarket	2.50%	1.00%	3.50%	\$104.00	79%	\$81.86
Upscale Submarket	2.50%	-1.00%	1.50%	\$133.00	77%	\$101.89
Overall Market				\$116.00	78%	\$90.31
Source: Kennedy & Mohn, P.S.						

CONCLUSION

Based on our current analysis, the Anchorage lodging market appears to have weathered the last two years remarkably well and better than previously projected. While the last round of supply change unfolded largely as expected, its impact on the market was not detrimental as growth in demand outpaced growth in supply. The market should benefit in 2006 from delayed construction of the Embassy Suites and Holiday Inn projects which were previously expected to follow more closely to the last wave of development. While these projects are expected to move forward, their delay has created a more measured flow of new supply and an opportunity for operators of existing hotels to refine or reinforce their positions prior to the next wave of new development. Overall, the Anchorage lodging market is more dynamic and more optimistic than we found it during our prior analysis, due to a variety of factors, not the least of which are the convention center expansion, the economic lift provided by \$60/barrel oil, and the jaded optimism that something big could break loose in the form of ANWR or a natural gas pipeline.

We trust that AIDEA will find the updated analysis and commentary presented in this report to be beneficial for developing an improved level of understanding regarding the current factors influencing the lodging market in Anchorage. Should you have any questions or require clarification on any of the issues discussed in this report, please do not hesitate to contact us.

Sincerely,

Kennedy & Mohn, P.S.

Kennedy & Mohn, P.S.

By: Michael J Mohn, MAI

Certified General Real Estate Appraiser

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MJM:tpk

GENERAL ASSUMPTIONS

This preliminary market feasibility study report has been prepared under the following general assumptions:

- ◆ No responsibility is assumed for matters of a legal nature.
- ◆ Responsible ownership and competent property management are assumed.
- ◆ The information provided by others is believed to be reliable. However, no warranty is given for its accuracy.
- ◆ All engineering is assumed to be correct. The plot plans and illustrative material in this report are included only to assist the reader in visualizing the property.
- ◆ It is assumed that there are no hidden or unapparent conditions of the property, subsoil, or structures that render it more or less useful. No responsibility is assumed for such conditions or for arranging for engineering studies that may be required to discover them.
- ◆ Full compliance with all applicable federal, state, and local environmental regulations and laws is assumed.
- ◆ Full compliance with all applicable zoning and use regulations and restrictions is assumed.
- ◆ It is assumed that all required licenses, certificates of occupancy, consents, or other legislative or administrative authority from any local, state, or national government or private entity or organization have been or can be obtained.
- ◆ It is assumed that the utilization of the land and improvements is within the boundaries or property lines of the property described and that there is no encroachment or trespass.

LIMITING CONDITIONS

This preliminary market feasibility study report has been prepared under the following general limiting conditions:

- ◆ Possession of this report, or a copy thereof, does not carry with it the right of publication. It may not be used for any purpose by any person other than the party to whom it is addressed without the written consent of Kennedy & Mohn, P.S., and in any event only with proper written qualification and only in its entirety.
- ◆ Kennedy & Mohn, P.S., is not required to give further consultation, testimony, or be in attendance in court with reference to this report unless arrangements have been previously made.
- ◆ Projections of future revenue, expenses, net operating income, mortgage debt service, capital outlays, cash flow, or inflation represent our judgment of the assumptions likely to be used by informed persons in the marketplace. These estimates are intended solely for analytical purposes and are not intended to accurately predict future results or events. Actual performance will differ from these projections, and these differences may be significant.
- ◆ In accordance with our contract with the client, the accompanying analysis is not intended to be a complete market analysis or appraisal. The purpose of this market overview feasibility study is to assist in the initial development planning of the client. The results of this market overview analysis are subject to change based on completion of a full market study or appraisal.
- ◆ Unless otherwise stated in this report, the existence of hazardous substances, including without limitation asbestos, polychlorinated biphenyls, petroleum leakage, or agricultural chemicals, which may or may not be present on the property, or other environmental conditions, were not called to the attention of nor did the consultant become aware of such during the consultant's inspection. The consultant has no knowledge of the existence of such materials on or in the property unless otherwise stated. The consultant, however, is not qualified to test such substances or conditions. The presence of such substances, such as asbestos, urea formaldehyde foam insulation, or other hazardous substances or environmental conditions, may affect the feasibility of the project. Our analysis is predicated on the assumption that there is no such condition on or in the property or in such proximity thereto. No responsibility is assumed for any such conditions, nor for any expertise or engineering knowledge required to discover them.

CERTIFICATION

I certify that, to the best of my knowledge and belief:

- ◆ The statements of fact contained in this report are true and correct.
- ◆ The reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, impartial, and unbiased professional analyses, opinions, conclusions, and recommendations.
- ◆ I have no present or prospective interest in the property that is the subject of this report, and I have no personal interest with respect to the parties involved.
- ◆ I have no bias with respect to any property that is the subject of this report or to the parties involved with this assignment.
- ◆ My engagement in this assignment was not contingent upon developing or reporting predetermined results.
- ◆ My compensation for completing this assignment is not contingent upon the development or reporting of a pre-determined value or direction in value that favors the cause of the client, the amount of the value opinion, the attainment of a stipulated result, or the occurrence of a subsequent event directly related to the intended use of this report.
- ◆ The reported analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the requirements of the Code of Professional Ethics & Standards of Professional Appraisal Practice of the Appraisal Institute, which include the *Uniform Standards of Professional Appraisal Practice*.
- ◆ The use of this report is subject to the requirements of the Appraisal Institute relating to review by its duly authorized representatives.
- ◆ I have made a personal inspection of the property that is the subject of this report.
- ◆ No one provided significant real property appraisal or appraisal consulting assistance to the persons signing this certification.
- ◆ As of the date of this report, Michael J. Mohn, MAI has completed the continuing education program of the Appraisal Institute.

Michael J. Mohn

Michael J. Mohn, MAI

CCERT Ver.5/2005