

**Hotel Market Analysis  
Fairbanks, Alaska  
March 2008**

**Prepared for**

**AIDEA**

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## **INTRODUCTION**

This following report is an update of earlier studies prepared for AIDEA in June 2004 and October 2005 for the purpose of understanding the relative strength or weakness of the local lodging market in Fairbanks. The current document has been revised and updated to reflect current economic conditions and performance data for the Fairbanks lodging market through year-end 2007, 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 tourism industry in the state and local markets. The data and opinions set forth in this report are based on our fieldwork and follow-up research conducted through March 2008.

## **ECONOMIC OVERVIEW**

### **Local Market Overview**

Fairbanks is located in the Tanana Valley, deep in Alaska's interior region, 358 miles northeast of Anchorage, 125 miles south of the Arctic Circle, and 498 miles south of Prudhoe Bay. The Fairbanks North Star Borough is Alaska's second largest metropolitan area, with a 2007 population of approximately 91,000 persons, constituting roundly 13 percent of the state's total population of approximately 677,000. Fairbanks is the hub of much of the economic activity occurring in Alaska's vast interior region due to its connection to each of the five major highway systems serving the region. Given the remoteness of much of Alaska, the extensive highway system surrounding Fairbanks is a significant asset to independent tourists and commercial travelers alike, with comparatively easy connections north to Prudhoe Bay; southwest to Denali, Anchorage, and the Kenai Peninsula; and southeast to Beaver Creek, Whitehorse, and Skagway.

This geographic location contributes heavily to the allure and the complexities of life and business in Fairbanks. Weather conditions vary dramatically throughout the year in Fairbanks. Winter temperatures average 13 degrees below zero, but can fall to as much as 40 and 50 degrees below zero. In contrast, summer temperatures average 70 degrees and can reach into the 90's during July and early August. During the depths of winter, there may be as few as four hours of daylight each day whereas during summer periods daylight extends to 18 to 20 hours each day.

While temperatures this severe have a natural tendency to limit all but the most essential travel, they also coincide with optimal viewing times for the Northern Lights, which is clearly one of Fairbanks' greatest winter tourism assets. The area's intense winter cold also fuels the economy by providing a perfect environment for advanced cold-weather testing activities that occur in the surrounding area. Despite the often-intense cold, Fairbanks holds a number of winter festivals for residents and guests and during October 2005 and October 2007, was the host city for the Alaska Federation of Natives convention (AFN), the state's largest conference.

Fairbanks is also served by the Alaska Railroad, which opened a new \$22.5 million passenger terminal in 2005, located approximately one-mile west of downtown. Air service to Fairbanks is

accommodated at the Fairbanks International Airport (FIA), five miles west of downtown. FIA is completing construction of a major new passenger terminal that will be substantially complete later this year, with renovation of existing terminal space to be completed by Summer 2009. These projects will greatly enhance the guest experience at the airport and will improve international arrivals and customs processing. Alaska Airlines provides year round service to Fairbanks, while several other airlines provide peak season connections to the lower-48 and to Europe. Fairbanks infamous “Northern Lights” continues to attract winter tourism from Japan, with 18 private charter flights in 2007, up from 3 flights in 2004. These guests typically stay in the area for four days, alternating between Fairbanks and Chena Hot Springs.

### **Economic Indicators**

As shown in Table 1 on the following page, job growth in the Fairbanks Northstar Borough averaged 1.9 percent annually during the 2003 to 2007 period, representing only a small part of 19 consecutive years of employment growth in the market. Unemployment rates in the market have been trending down in recent years, falling from 6.9 percent in 2003 to 5.2 percent in 2007. State economists forecast continued employment growth in 2008. Employment growth rates in recent years have tapered off to slightly less than one percent growth annually, with the strongest rates indicated within the Manufacturing sector (7.9%), followed by Financial Services sector (5.7%), and the Professional and Business sector (3.6%).

The construction sector in Fairbanks has been a very dynamic sector of the economy in recent years, posting growth of 3.1 percent over the period. Military sponsored projects at Fort Wainwright and Eielson AFB will continue into 2008, as will large State funded projects at the University and at the airport. Private sector construction includes the expansion of Wal-Mart, the remodel of Sam’s Club, a new Safeway, and completion of the Morris Thompson Cultural and Visitors Center downtown. Fairbanks will see three new hotels built in three years, starting with the Alpine lodge in mid-2007, Holiday Inn Express in mid-2008, and Hampton Inn in mid-2009.

Fairbanks is also home to extensive mining activities which, while economically significant, do not contribute substantially to the overall employment base. In 1995, the Pogo gold deposit was discovered about 90 miles southeast of Fairbanks, with subsequent studies indicating that it contains over 5 million ounces of identified gold reserves. After nearly ten years of permitting and construction and \$300M in investment, the Pogo Mine officially opened in June 2006. The mine is expected to produce 375,000 to 500,000 ounces of gold annually over a 10-year life and employ 250 to 300 persons. By comparison, the Fort Knox Gold Mine opened in 1997, reportedly with over 4 million ounces of identified gold reserves is producing 330,000 ounces of gold annually with employment of 400 to 425. Recent permits were issued for a heap leach facility at Fort Knox that will increase employment and extend the life of mining activity at this location. High mineral prices in recent years bode well for continued mining activities in the area.

<b>Table 1</b>						
<b>Fairbanks Northstar Borough Economic Indicator Summary</b>						
<b>Employment:</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007*</b>	<b>CAAGR</b>
Total Industries	35,614	36,920	37,898	38,128	38,400	1.9%
% chg.		3.7%	2.6%	0.6%	0.7%	
<b>Goods Producing</b>						
Natl. Resource & Mining	953	981	1,211	1,346	900	-1.4%
Construction	2,482	2,776	2,911	2,764	2,800	3.1%
Manufacturing	517	565	622	632	700	7.9%
<b>Service Providing</b>						
Trade, Trans. & Utilities	7,234	7,477	7,805	7,744	7,800	1.9%
Information	604	576	575	593	600	-0.2%
Financial	1,282	1,312	1,402	1,575	1,600	5.7%
Prof. & Business	1,998	2,102	2,117	2,098	2,300	3.6%
Education & Health	3,901	1,089	4,194	4,277	4,200	1.9%
Leisure & Hospitality	4,000	4,225	4,137	4,109	4,300	1.8%
Government	11,267	11,484	11,552	11,621	11,900	1.4%
<b>Unemployment Rate:</b>	6.9%	6.4%	5.8%	5.6%	5.2%	
<b>Population:</b>						
State of Alaska	647,773	647,314	664,060	670,958	676,987	1.1%
Anchorage	273,024	277,810	278,294	283,244	283,823	1.0%
Fairbanks	28,924	30,101	31,104	30,179	31,627	2.3%
Fairbanks North Star Borough	82,160	85,453	87,704	87,766	90,963	2.6%
Juneau City & Borough	31,294	31,122	31,225	30,811	30,305	-0.8%
Denali Borough	1,916	1,850	1,823	1,796	1,731	-2.5%
<b>Fairbanks International Airport</b>						
Total Air Passengers	830,415	881,118	924,364	918,012	966,898	3.9%
Incoming	419,199	445,750	464,464	462,703	494,879	4.2%
Outgoing	411,216	435,368	459,900	455,309	472,019	3.5%
Cargo (non-transit) 000#	68,485	70,498	78,952	62,676	52,389	-6.5%
<b>Lodging Tax Receipts</b>						
Fairbanks Northstar Borough	\$1,413,877	\$1,553,132	\$1,520,969	\$1,584,040	\$1,803,680	6.3%
City of Fairbanks	\$1,805,682	\$2,142,759	\$2,376,095	\$2,606,629	\$2,685,417	10.4%
Total	\$3,219,559	\$3,695,891	\$3,897,064	\$4,190,669	\$4,489,097	8.7%
% chg.	3.5%	14.8%	5.4%	7.5%	7.1%	
<b>Cruise Passenger Trends</b>						
Total Cruise Passengers	777,000	884,400	953,400	958,900	1,029,800	7.3%
% chg.	5.0%	13.8%	7.8%	0.6%	7.4%	
<b>Denali National Park</b>						
Total Visitors	359,838	404,234	403,520	415,935	458,307	6.2%
% chg.	1.8%	12.3%	-0.2%	3.1%	10.2%	
<b>Inflation Trends - CPI-U</b>						
Anchorage	2.7%	2.6%	3.1%	3.2%	2.2%	
United States	1.6%	2.3%	2.7%	3.2%	2.8%	
* ALMIS Feb-07 Benchmark Data						
Sources: Alaska Dept. of Labor; US Census, Fairbanks Borough, FCVB, FIA, NPS						

Oil production related employment is a major driver of the state's resource-based economy, if not a dominant employer. With current record high oil prices approaching \$115 per barrel, the State of Alaska was rewarded with massive royalties that filled state coffers in 2007, resulting in extensive state spending in the recently passed \$11B operating budget, \$2.9B capital budget, and \$5B deposited to state savings accounts. The stratospheric rise in oil prices have resulted in a dramatically renewed interest in exploration and development activities in the oil and gas sectors, as evidenced by Shell Oil Company's continuing efforts to gain approval for exploration of coastal waters in the Beaufort Sea, just offshore from ANWR and its recent involvement in

securing \$2.1 billion in oil and gas leases in the Chukchi Sea off of Alaska's northwest coast in February 2008.

The biggest item on the horizon in the oil and gas industry in Alaska hinges on current legislative efforts to secure proposed construction of a proposed \$30B natural gas pipeline. Trans-Canada provided the only AGIA compliant proposal for development of the pipeline, which is currently under reviewed by the Governor's office and is expected to be presented to the state legislature in the upcoming special session in mid-2008. Meanwhile, Conoco-Phillips announced that it would pursue its own version of the gas pipeline without the \$500M in state subsidies offered under AGIA. In early April, BP announced it would join forces with Conoco to pursue development of the gas line, with this new venture expected to spend \$600M over the next three years on engineering and fieldwork related to the project. While the outcome is still far from certain, it appears that Alaska may soon be capitalizing on a project that it has pursued for over 30 years. Given the massive cost and scale of this \$30 billion project, its economic impact within the state would be substantial, although it is likely to be distributed over a protracted period of time. If this project moves forward, Anchorage would likely play a key role in the development and planning phases, whereas Fairbanks would likely benefit more heavily during the construction phase.

The current level of interest and the amount of capital that is being committed to this project are favorable indicators that provide direct benefit to the local economy while fueling speculation and anticipatory spending. However, while this project now appears closer to fruition than at any time in its 30-year history, there is still no certainty that it will move forward. While our projections are not predicated on the gas line moving forward, the successful launch of this project would clearly signal the beginning of another major boom period for the economy of the state as a whole.

Between 2003 and 2007, the population in the Fairbanks North Star Borough increased by approximately 8,800 persons, yielding a robust growth rate of 2.6 percent annually. The local military installations, Fort Wainwright Army Base and Eielson Air Force Base accounted for approximately 21 percent of the population in the Borough, or roundly 19,400 persons in 2007. During the 2003 to 2007 period, the military population in Fairbanks grew at 3.4 percent annually, which contributed significantly to the overall growth in population in the area. This growth was attributed primarily to Fort Wainwright, as a result of the transformation of the 172<sup>nd</sup> Brigade from a light-infantry brigade to a Stryker brigade. Population growth within the City of Fairbanks posted a 2.3 percent average annual growth between 2003 and 2007, reversing a declining trend in population since the late 1990's.

The U.S. military continues to exert significant influence on the economy of the Fairbanks area, with two nearby military bases including Fort Wainwright Army Base and Eielson Air Force Base. Collectively, these two bases reported over 7,700 active military personnel in Q4-2007 (19,378 including family members and dependents). With growth in the military population of 3.4 percent annually in recent years and continued growth expected through 2013. The combined effects of increasing military population and deployment cycles created a substantial need for off-base lodging in the Fairbanks market in late 2006 and early 2007 when the military

contracted approximately 400 units in area hotels and apartments, representing nearly 40,000 room nights of demand. While only a portion of this demand was accommodated within the mid-market and upscale hotels in Fairbanks, the resulting compression in the market influenced the performance of all properties. Military sources indicated that this event was likely an isolated occurrence and military demand for off-base lodging in future years is expected to return to more traditional levels of 4,000 to 6,000 rooms annually.

The tourism sector has a dramatic influence on the economy of Fairbanks and that of the state as a whole, with the primary drivers being the cruise industry and the lodging industry. Summer visitor studies completed in recent years indicated summer visitors to the state have increased by over 6.9 percent annually between 2003 and 2007, with approximately 38 percent arriving by cruise ship and 52 percent by air. Cruise passenger volumes grew by 7.3 percent annually between 2003-2007 with the Alaska cruise industry reporting roundly 1,030,000 cruise passengers in 2007. Thus far, the 2006 passage of the head-tax on cruise passengers appears to have had no material impact on cruise demand patterns in the state. Fairbanks continues to benefit from its location as a turn-point for most land-tour alternatives in the state. Air passenger data recorded at Fairbanks International Airport for 2007 indicates nearly 967,000 total passengers for the year, an increase of more than 136,000 passengers since 2003. Average annual passenger growth during this period averaged 3.9 percent. Lodging tax receipts in the Fairbanks market have posted an 8.7 percent average annual increase between 2003 and 2007, reflective of growth in tourist volumes in recent years and increases in the quality and quantity of the available rooms inventory in the market during this period.

In 2007, Fairbanks began a planning process entitled '*Vision Fairbanks*' aimed at identifying opportunities to enhance and revitalize the downtown area. The results of this planning exercise were published in February 2008. One of numerous opportunities identified in the study was potential for development of a civic-anchor for the downtown core. As envisioned by the planners, this component would potentially include a community center, performing arts center, convention center, and potentially a convention hotel. The location recommended for these facilities is near the intersection of Airport Way and Cushman Avenue, at the southern fringe of the downtown core. While this study was only recently completed and implementation is likely years away at best, we understand that the Fairbanks Convention & Visitors Bureau is expected to engage a consultant in 2008 to conduct a feasibility study that will explore the viability of developing a convention center in Fairbanks. The outcome of this feasibility study and the gradual implementation of the recommendations set forth in the *Vision Fairbanks* study will be important to monitor in future years.

Denali National Park remains the emotional heart of Alaska's tourism industry and is a dominant component of most land tour packages. Denali National Park visitor volumes were up over 10 percent in 2007 and averaged 6.2 percent annually over the 2003 to 2007 period. Fairbanks is a direct recipient of strong demand patterns in Denali, despite the substantial increases to the hotel inventory in Denali in recent years. While much of the increased inventory has been used to accommodate longer stays at Denali, the bottleneck remains the federal cap on park visitation. Access restrictions within the park will continue to limit the quantity and quality of the Denali experience for many visitors to the state. After numerous rounds of planning since the 1960's, it

appears that consensus has finally been reached regarding additional access and development near the southern portions of Denali National Park. Current plans call for development of the new south Denali access road at milepost 134 of the Parks Highway. The new road will extend 3.5 miles to Curry Ridge, where a 16,000 square foot, \$26M visitor center and 13-miles of hiking trails are planned for development. While the south access project will benefit all visitors to Denali National Park, the communities and businesses south of the park are expected to see significant benefit.

A variety of macroeconomic factors are influencing demand patterns in the current environment and are expected to continue to do so over the near term. The softening or near recessionary conditions in the larger U.S. economy, skyrocketing costs of fuel and groceries, tightening lending markets, and the recent collapse of the sub-prime mortgage markets, all translate to lower levels of discretionary income. These factors are expected to exert downward pressure on leisure travel patterns over the near to mid-term. Conversely, the low value of the dollar on the world currency markets tends to enhance domestic travel patterns while allowing the U.S. to capture a larger share of the foreign travel markets. Alaska is expected to remain a highly desirable travel destination for domestic and foreign visitors alike. Also on the positive side, unlike the rest of the nation, Alaska markets may see continued benefit from high oil, gas, and minerals pricing which enhances exploration and development activity in the state's resource-based economy, thereby resulting in upward pressure on commercial demand patterns. While the macroeconomic signals are somewhat negative, we are reasonably confident that Alaska will avoid a major downturn in its economy and that softening or declines in one sector may be offset by growth in other sectors.

## **LODGING MARKET ANALYSIS**

### **Fairbanks Lodging Market Overview**

The Fairbanks hotel market is unique in several ways; firstly, there is no distinct core or central concentration of hotel properties. Instead, the lodging product is more widely diffused throughout the market. Locationally, several properties are found in, or near, the downtown core, several more are located along the Chena River, near the airport, and the remainder are distributed between these two areas. The latest round of new hotel properties to enter the market will be located in a rapidly developing retail area in the northeast part of the city, near the intersection of the Steese and Johansen Expressways, adding further to the diffuse nature of the local lodging market. However, because the distance between these areas is relatively short, most travelers seeking accommodations in Fairbanks typically base their decision on factors other than geographic location within the city. The lodging market in Fairbanks also has no distinct quality center. In many markets, the larger first-class facilities tend to be concentrated together, often in a downtown core. In Fairbanks, the upscale properties are equally represented in both the downtown and airport areas.

Lodging demand patterns in the Fairbanks market are influenced very heavily by cruise patterns, and independent leisure and packaged tour products that have Denali National Park at their core. This demand remains heavily concentrated during peak summer season from mid-May through mid-September. During this period, a substantially larger inventory of guestrooms can be sustained in Fairbanks than at most other times during the year. As a result, there are a comparatively large number of guestrooms in the market that are operated seasonally, or change from extended-stay or apartment-type use during the shoulder and off-peak periods, to more traditional transient use during peak season periods. Some properties, such as Wedgewood Resort, Bridgewater Hotel, and Bear Lodge, routinely maintain pure hotel operations on a peak season basis, while others vary the available inventory of guestrooms by season.

The inventory of seasonally operated hotels has changed during each of our prior reviews of the Fairbanks lodging markets and this year is no exception. The Captain Bartlett Inn is currently operating only 30 of its 197 total guestrooms during off-peak periods, down from 60 off-peak rooms in prior years. The former Best Western Fairbanks Inn closed for renovations and re-branding at the end of 2007 and is slated to begin operating its 102 available rooms during peak season only starting in 2008. Conversely, during its first year of operations, the new Alpine Lodge, near the airport, had planned to keep its top floor of guestrooms on hold-warm status during the off-peak season, but pleasantly found adequate demand in the market to keep these rooms open year-round. Changes in the seasonal availability of guestroom inventory in the market in any given year may be prompted by such factors as changing economic conditions, changes in ownership, or a property's changing competitive position in the market. The ebb and flow patterns of guestroom inventory continue to be beneficial to the market in that they serve as a pressure-relief valve for volatile swings in demand; but they also make market performance comparisons between years more difficult and inherently imprecise.

Similar to our prior analysis of the market, we categorize the competitive lodging market in Fairbanks into two primary tiers of quality, upscale and mid-scale. Properties have been



classified based on physical attributes, service quality, room pricing, and performance. However, there has been a shift in the properties included in our analysis this year and going forward during our projection period as a result of changes from year-round to seasonal operations for several of the hotels. Specifically, we have removed the Captain Bartlett Inn and the River's Edge Resort from the historical data trends due to their predominantly seasonal operations, at present. We include the formerly Best Western Fairbanks Inn within the historical data trends, although it is removed from our projections beginning in 2008 due to the planned seasonal operations of this facility. Our analysis also excludes many of the smaller, older, or independent hotels in the market.

The upscale lodging market in Fairbanks consists of four hotels at the present time, including the Westmark and the Springhill Suites downtown, and the Princess Riverside Lodge and Pike's Waterfront Lodge, both located along the Chena River, near the airport. These hotels range in size from 140 to 400 rooms; and collectively, they represent a peak season inventory of 1,073 available guestrooms. The upscale hotels are each full-service facilities, offering at least one restaurant and lounge, and meeting and banquet space ranging from less than 900 square feet to nearly 17,000 square feet. The available room supply in the upscale lodging market has been static at its current level since 2005, following the May 2004 opening of Westmark's new tower, which brought their total inventory up to 400 available rooms. Pike's Waterfront Lodge also opened 28 cabins in June 2004, clustered along a section of riverfront adjacent to the existing hotel.

The mid-scale lodging market in Fairbanks currently consists of six hotels, including three independents and three with national franchises. These hotels range in size from 74 rooms to 148 rooms representing a 2007 peak season inventory of 664 available rooms. The size, type, and quality of facilities offered in the mid-scale market are considerably more diverse than in the upscale market. The three oldest properties in this submarket are full-service properties, offering food and beverage facilities and 1,900 to 2,400 square feet of meeting and conference space. The Comfort Inn and Extended Stay Deluxe, were opened in 1996 and 2001, respectively. These properties are limited-service hotels without food and beverage or significant meeting space. The Extended Stay Deluxe is the former Aspen Hotel which was sold to Blackstone in 2006. Following the acquisition, the buyer renovated the property and added kitchens to the guestrooms, converting it to the Extended Stay Deluxe brand. The newest hotel in this submarket is the Alpine Lodge, which opened in April 2007 with 115 guestrooms. The Alpine Lodge is currently under construction on a 7,000 square foot lodge building that will house a new restaurant and 2,800 square feet of meeting space, which is scheduled to open in May 2008. Reportedly, the Alpine Lodge also has additional land that could accommodate a future guestroom expansion when the market warrants.

The following table identifies those properties in each of the two primary tiers, including key physical attributes and the current seasonal published pricing of guestrooms.

<b>Table 2</b>										
<b>Profile of the Competitive Hotel Properties</b>										
<b>Fairbanks, Alaska</b>										
<b>Mid-Scale Submarket</b>	<b>Submarket</b>	<b>Date</b>	<b>Rooms</b>	<b>F&amp;B</b>	<b>Meeting Space</b>		<b>2008</b>			<b>Amenities</b>
					<b>Total</b>	<b>Largest</b>	<b>Rack Single/Double</b>			
					<b>Area (SF)</b>	<b>Room (SF)</b>	<b>Summer</b>	<b>Winter</b>		
Alpine Lodge	Airport	2007	115	0/0	4,305	3,000*	\$189-\$219	\$79-\$109	BCDEF	
Extended Stay Deluxe	Airport	2001	97	0/0	1,200	1,200	\$170-\$189	\$80	ABCE	
Best Western Fairbanks Inn	Downtown	1970	102	1/1	2,400	1,400	\$134-\$179	n/a	CE	
Comfort Inn	Downtown	1996	74	0/0	500	500	\$162 - \$189	\$72-\$80	ABCE	
Regency Fairbanks	Downtown	1985	128	1/1	2,200	1,175	\$195-\$246	\$75-\$102	CDE	
Sophie's Station	Airport	1986	148	1/1	1,925	1,225	\$185-\$245	\$89-\$99	CE	
Subtotal			664		12,530					
<b>Upscale Submarket</b>										
Westmark Fairbanks Hotel	Downtown	1984-2004	400	2/1	16,700	5,400	\$185 - \$234	\$89 - \$109	CDEF	
Princess Riverside Lodge	Airport	1993-2001	325	2/1	9,450	4,800	\$199-\$219	\$89 - \$139	BCDEF	
Pike's Waterfront Lodge	Airport	2000-2004	208	1/1	6,330	2,800	\$234-\$250	\$89-\$159	BCDEF	
Springhill Suites	Downtown	2001	140	1/1	860	500	\$229	\$89 - \$104	ABCDEF	
Subtotal			1,073		33,340					
<b>TOTAL COMPETITIVE MARKET</b>			<b>1,737</b>		<b>45,870</b>					
						Amenities	A Pool	D	Bus. Ctr.	
							B Spa/Steam	E	Gst Ldry.	
							C Exercise	F	Retail	

\* Meeting space to open 2008

Source: K&M interviews, AAA-2008, individual websites

**Historical Supply and Demand**

Table 3, presented on the page 10, summarizes information regarding the historical operating performance of the competitive hotels in the mid-scale and upscale markets in Fairbanks for the period 2003 through 2007. Key indications from this summary are as follows:

- ◆ The growth in the available room supply in the overall market shows a net gain of 451 available rooms on an annualized basis over the 2003 to 2007 period, indicating a compound average annual growth of 8.1 percent. The upscale submarket accounted for 271 new rooms, reflecting the addition of the Westmark tower in May 2004 and the 28 new cabins at Pikes Lodge one month later. The mid-scale submarket accounted for 180 new rooms (annualized) during the period, including 102 rooms at the Best Western Fairbanks Inn which re-opened for year-round operations in May 2004 and the opening of the 115-room Alpine Lodge in late April 2007.
- ◆ Based on historical data and our recent interviews in the market, we estimate that rooms demand in the overall market grew at 12.3 percent annually over the 2003 through 2007 period. Within the mid-scale submarket demand growth was approximately 13.6 percent annually, compared to 11.5 percent annually in the upscale submarket. Given the highly seasonal nature of demand patterns in the Fairbanks market, demand growth rates in both submarkets are heavily influenced by increases in the available rooms supply during peak summer periods when the better quality hotels in the market typically operate at or near capacity. Growth in recent years was also enhanced by the fact that supply changes in the upscale submarket were readily absorbed by the major

tour operators in the market, which is considerably less likely to occur at the newer limited-service properties in the mid-scale submarket.

- ◆ The resulting occupancy rates in the overall market showed significant increases in recent years, climbing from 56 percent in 2003 to 59 percent in 2004 as a result of opportune timing of new supply additions. Occupancies fell in 2005 to 56 percent as absorption of the new rooms continued. Generally speaking, during the 2003 through 2005 period fluctuations in occupancy rates were influenced by the timing of new supply and rotational shifts in off-peak convention activity, namely AFN. Market occupancies were pushed upward in 2006 and again in 2007 due to an unforeseen influx of a large component of military demand which caused the market occupancy rate to swell to 60 percent in 2006 and 65 percent in 2007.
- ◆ Based on our interviews with officials at Fort Wainwright, we estimate that roundly 51,000 room nights of military demand was contracted in the Fairbanks market during the 2006/2007 period. We estimate that approximately 29,000 room nights of this demand were accommodated within the hotels in the competitive market, with the balance occurring at properties outside of the competitive market as defined. Approximately 70 percent of the demand within the competitive market was captured by hotels in the mid-scale submarket with the remaining 30 percent captured by the upscale market hotels. The resulting compression in the market benefited all hotels during this period, regardless of whether they were the direct recipients of military demand.
- ◆ The large infusion of military demand was an anomaly resulting from atypical troop rotation patterns and is not expected to recur in future years. As a result, this demand will be extracted from the market within our projections of future year performance. If we exclude the influence of military demand from 2006 and 2007, occupancies for the overall market would have been approximately 59 percent in 2006 and 62 percent in 2007, thereby yielding a somewhat lower average growth rate for the overall market during the period of roundly 10.2 percent annually.
- ◆ The ‘flight to quality’ mentioned in our prior studies of the Fairbanks market, has continued in recent years, with the newer properties and the nationally branded hotels generally out-performing the older independent properties. The larger tour-operated hotels, Westmark and Princess continue to do extremely well during summer period as they control a large share of the demand flowing to the market, but they continue to battle amongst each other for meetings and group events to fill their large inventory of guestrooms during off-peak periods.

<b>Table 3</b>											
<b>Competitive Lodging Market Overview - 2003 through 2007</b>											
<b>Fairbanks, Alaska</b>											
	<u>Available Rooms</u>		<u>Fair</u>	<u>Occ.</u>	<u>Occupied</u>	<u>Market</u>	<u>Penetr'n</u>	<u>Average</u>	<u>Room Revenue</u>		<u>REVPAR</u>
	Daily	Annually	Share	Rate	Rm. Nights	Share	Rate	Rm. Rate	Total	Per Rm.	Index
<b><u>2007</u></b>											
Mid-Scale Submarket	627	228,905	37.3%	66%	152,200	38.0%	101.6%	\$102.00	\$15,573,942	\$68.00	91.9%
Upscale Submarket	1,052	384,001	62.7%	65%	248,800	62.0%	99.0%	\$121.00	\$30,019,160	\$78.00	105.4%
Total Market	1,679	612,906	100.0%	<b>65%</b>	401,000	100.0%	100.0%	\$114.00	\$45,593,102	\$74.00	100.0%
% chg.		4.9%			14.3%				16.5%	10.4%	
<b><u>2006</u></b>											
Mid-Scale Submarket	549	200,385	34.3%	63%	126,800	36.1%	105.4%	\$95.00	\$12,005,116	\$60.00	89.6%
Upscale Submarket	1,052	384,001	65.7%	58%	224,100	63.9%	97.2%	\$121.00	\$27,135,531	\$71.00	106.0%
Total Market	1,601	584,386	100.0%	<b>60%</b>	350,900	100.0%	100.0%	\$112.00	\$39,140,647	\$67.00	100.0%
% chg.		0.0%			6.4%				9.0%	9.8%	
<b><u>2005</u></b>											
Mid-Scale Submarket	549	200,385	34.3%	61%	121,900	37.0%	107.8%	\$88.00	\$10,712,099	\$53.00	86.9%
Upscale Submarket	1,052	384,001	65.7%	54%	207,900	63.0%	95.9%	\$121.00	\$25,186,409	\$66.00	108.2%
Total Market	1,601	584,386	100.0%	<b>56%</b>	329,800	100.0%	100.0%	\$109.00	\$35,898,507	\$61.00	100.0%
% chg.		10.3%			6.2%				7.2%	-3.2%	
<b><u>2004</u></b>											
Mid-Scale Submarket	515	188,145	35.5%	58%	110,000	35.4%	99.8%	\$83.00	\$9,183,080	\$49.00	77.8%
Upscale Submarket	937	341,897	64.5%	59%	200,500	64.6%	100.1%	\$121.00	\$24,307,817	\$71.00	112.7%
Total Market	1,452	530,042	100.0%	<b>59%</b>	310,500	100.0%	100.0%	\$108.00	\$33,490,897	\$63.00	100.0%
% chg.		18.3%			23.0%				29.2%	8.6%	
<b><u>2003</u></b>											
Mid-Scale Submarket	447	163,155	36.4%	56%	91,300	36.2%	99.4%	\$86.00	\$7,873,354	\$48.00	82.8%
Upscale Submarket	781	285,065	63.6%	57%	161,100	63.8%	100.4%	\$112.00	\$18,045,845	\$63.00	108.6%
Total Market	1,228	448,220	100.0%	<b>56%</b>	252,400	100.0%	100.0%	\$103.00	\$25,919,199	\$58.00	100.0%
% chg.											
<b><u>Compound Average Annual Growth Rate 2003 - 2007</u></b>											
Mid-Scale Submarket		8.8%			13.6%			4.4%		9.1%	
Upscale Submarket		7.7%			11.5%			2.0%		5.5%	
Total Market		8.1%			12.3%			2.6%		6.3%	

Source: Kennedy & Mohn, P.S.

- ◆ Average room rates within the overall market increased from roundly \$103 to \$114 during the 2003 to 2007 period, posting a 2.6 percent average annual growth rate, comparable to the underlying rate of inflation. The mid-scale submarket achieved stronger growth in average room rate during the period, 4.4 percent compared to 2.0 percent in the upscale submarket. We attribute the disparity in growth to a variety of factors including the disproportionate capture of military demand between submarkets, the mid-year opening of the Alpine Lodge in 2007, and the re-branding and repositioning of the former Aspen Hotel during 2006 and 2007. We expect some softening in the growth in average room rates within the overall market in 2008 and beyond, with potentially greater impact on the existing properties in the mid-scale submarket as the newer nationally branded hotels enter the market in 2009 and 2010.

- ◆ The overall market achieved growth in revenue per available room (RevPAR) during the 2003 to 2007 of 6.3 percent annually, increasing from roundly \$58 to \$74. Stronger growth was posted by the mid-scale submarket at 9.1 percent annually compared to the upscale submarket at 5.5 percent annually. The disparity in growth rates between submarkets is attributed to those factors noted previously in our discussion of occupancy and average room rates.

### **Cruise/Tour Market Factors**

The Fairbanks market remains heavily reliant on cruise/tour demand generated by the large cruise lines and traditional motor-coach operators. Denali National Park remains the emotional heart of Alaska's tourism industry and is a dominant component of most land tour packages, regardless of the provider. Because most Denali packages include a start, stop, or turn in Fairbanks, the Fairbanks market is inextricably linked to Denali.

The dominant players in the state's cruise/tour market are Princess, Holland America, and Royal Celebrity. Both Princess and Holland America have a significant presence in the Fairbanks and Denali hotel markets, whereas Royal Celebrity typical contracts for rooms at CIRI properties or through other providers. Princess has repeatedly expanded their two wilderness lodges in Denali in recent years, from a combined rooms inventory in 2004 of 774 rooms to 1,116 rooms in 2008, an increase of 44 percent. Similarly, Holland America completed the 135-room first phase of a potentially 540-room lodge in Denali in 2006. While there are presently no active plans for the second phase expansion of this project, this could change at any time. Several years ago CIRI announced their intention to build approximately 200 new rooms in Denali and while this project has not moved forward yet, it also remains active. CIRI is also planning a 50-room expansion (scaled down from 100 rooms previously) to their Talkeetna Lodge property.

Unlike Anchorage, cruise/tour demand in Fairbanks continues to remain stable and has not been adversely impacted by the significant supply changes occurring in Denali. Fairbanks' geographic proximity to Denali and its position as a turn-around point in most itineraries continues to provide a modicum of stability within a potentially transient base of demand. Our recent interviews have produced mixed reviews from tour operators, with several indicating a moderate slowing of demand patterns for 2008, while others indicate that 2008 will be flat to slightly up from 2007 numbers. Macro economic factors including the softening economy in the lower-48 and perpetually increasing fuel costs could exert downward pressure on demand in this sector of the market.

### **Seasonal Factors**

With the exception of aberrant factors in the market in 2006 and 2007, lodging demand patterns in Fairbanks are highly seasonal, with peak season occurring from mid-May through mid-September, when cruise/tour related demand is at its peak. 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, upscale hotels in the market, and to a lesser extent, the seasonally operated properties. Many of the properties in the mid-scale submarket cater more heavily to the smaller tour operators and independent leisure

travelers, and they receive little direct contribution from the major cruise/tour companies. Off-season periods occur during the balance of the year, when leisure travel is minimal and the market relies more heavily on demand from the commercial and group segments. An increasingly significant amount of off-peak leisure demand is also attracted to Fairbanks during the height of the winter when the Northern Lights are readily visible in the surrounding area. Much of this demand is drawn from international markets in Asia and reportedly this component of demand has expanded rapidly in recent years, from three chartered 747 flights in 2004 to 18 chartered flights in 2007. Similar to the cruise/tour demand segment, this demand tends to be concentrated within the larger, full-service properties in the market.

Given the significant seasonal swings in demand, hotels in the market have historically used a two-tiered seasonal rate structure, with off-peak advertised rates 50 percent or more below the peak season rates. The combined effect of seasonal changes in room rates and demand patterns in recent years are visible in the historical trends in hotel room tax receipts reported by the City of Fairbanks and the Fairbanks North Star Borough, as shown in Table 4.

		<b>1st Qtr.</b>	<b>2nd Qtr.</b>	<b>3rd Qtr.</b>	<b>4th Qtr.</b>	<b>Total</b>	<b>% Chg.</b>
<b>2003</b>	City	203,470	468,777	937,433	196,002	1,805,682	-1.7%
	Borough	135,649	482,181	502,425	293,620	1,413,875	11.0%
	<b>Total</b>	<b>339,119</b>	<b>950,958</b>	<b>1,439,858</b>	<b>489,622</b>	<b>3,219,557</b>	<b>3.5%</b>
<b>2004</b>	City	202,259	658,129	1,046,797	235,573	2,142,759	18.7%
	Borough	138,415	558,093	596,293	260,600	1,553,401	9.9%
	<b>Total</b>	<b>340,674</b>	<b>1,216,222</b>	<b>1,643,090</b>	<b>496,173</b>	<b>3,696,160</b>	<b>14.8%</b>
<b>2005</b>	City	216,742	695,601	1,214,552	249,200	2,376,095	10.9%
	Borough	128,040	541,317	591,122	260,489	1,520,968	-2.1%
	<b>Total</b>	<b>344,782</b>	<b>1,236,918</b>	<b>1,805,674</b>	<b>509,689</b>	<b>3,897,063</b>	<b>5.4%</b>
<b>2006</b>	City	221,137	833,824	1,283,391	268,277	2,606,629	9.7%
	Borough	128,203	573,083	623,908	258,846	1,584,040	4.1%
	<b>Total</b>	<b>349,340</b>	<b>1,406,907</b>	<b>1,907,299</b>	<b>527,123</b>	<b>4,190,669</b>	<b>7.5%</b>
<b>2007</b>	City	258,787	857,719	1,305,931	262,981	2,685,417	3.0%
	Borough	158,703	315,042	1,021,234	308,701	1,803,680	13.9%
	<b>Total</b>	<b>417,490</b>	<b>1,172,761</b>	<b>2,327,165</b>	<b>571,682</b>	<b>4,489,097</b>	<b>7.1%</b>
<b>Total Market</b>							
<b>% of Annual (2007)</b>		9%	26%	52%	13%	100.0%	
<b>CAAGR 2005-2007</b>		10.0%	-2.6%	13.5%	5.9%	7.3%	
<b>CAAGR 2003-2007</b>		5.3%	5.4%	12.8%	3.9%	8.7%	
Source: Fairbanks Convention & Visitors Bureau - Hotel Bed Tax Receipts							

### 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. The following segmentation data reflects operator perceptions for 2007, excluding the influence of atypical military impacts in recent years.

- ◆ Commercial demand is composed of independent business travelers and state and federal government workers. Demand in the commercial segment is reasonably stable throughout the year, with modest declines during summer and holiday periods. Based on our recent interviews, we estimate this demand represents approximately 27 percent of total annual demand in the overall market in 2007.
- ◆ Leisure demand consists of independent and packaged leisure travelers, many of which come to Fairbanks while en-route to Denali. The packaged leisure component of this demand segment is heavily cruise-oriented and is concentrated almost exclusively within the peak summer season. We estimate the leisure demand segment to represent approximately 51 percent of total annual demand in the market.
- ◆ Group demand consists of conventions and meeting related travel to Fairbanks, and demand generated by sports teams and school events. Demand in this segment is typically concentrated during shoulder periods in the spring and fall. Current interviews suggest that group demand represents approximately 16 percent of total demand in the market.
- ◆ Contract demand is provided primarily by airlines and railroads serving Fairbanks. This demand makes up approximately six percent of total demand in the market and remains fairly heavily concentrated in the upscale submarket.

## SUPPLY AND DEMAND PROJECTIONS

In evaluating the performance potential of the Fairbanks lodging market in future years we have considered 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 the addition of new hotels that are expected to open in the market over the next several years. Projections of future demand growth 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

The table below identifies recent and proposed changes to the inventory of available guestrooms within the competitive market. Based on our research and interviews in the local market, we are aware of two new hotels and one recently opened hotel, all of which have been classified within the mid-scale submarket. Two of these new hotels will open in the rapidly developing retail area in northeast Fairbanks, near the intersection of the Steese and Johansen Expressways. At present, there are no hotels located in this area of Fairbanks. While somewhat pioneering in terms of location, both of these hotels will benefit from their affiliation with primary national brands with strong reservation systems and guest loyalty programs; each of these attributes is generally lacking in the Fairbanks market. While these hotels are not expected to benefit directly from the primary sources of cruise/tour demand in the market, they are expected to be extremely formidable competitors for motor-coach and independent leisure travelers, corporate/government travelers, and sports teams. Furthermore, the proximity of these hotels to the primary retail outlets in Fairbanks is also expected to enhance their performance as Fairbanks is increasingly able to satisfy bush-provisioning needs for much of Alaska's interior, a function that had previously been served by Anchorage.

<b>Recent and Pending Room Supply Changes - Fairbanks</b>					
<u>Property</u>	<u>Quality</u>	<u>Type</u>	<u>Location</u>	<u># Rooms</u>	<u>Opening</u>
<b><u>Recent Changes</u></b>					
Alpine Inn	Mid-scale	Transient	Airport	115	Apr-07
<b><u>Pending Room Changes</u></b>					
Holiday Inn Express	Mid-scale	Transient	Northeast	115	Jun-08
Hampton Inn	Mid-scale	Transient	Northeast	101	Jun-09
Source K&M - March 2008					

### 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 are induced by forces external to the market. Induced demand can be either positive or negative, with the opening of a new demand generator providing a positive inducement of demand, while the opening of competing hotels outside the competitive market, which draw off demand, would result in negative induced demand.

In arriving at our estimates of future demand growth, consideration was given to mix of demand by segment, seasonal patterns of demand, and the seasonal capacity constraints within the market. Key factors in our analysis are summarized in the following paragraphs.

- ◆ We estimate underlying growth in demand based on historical changes in key economic indicators, as presented previously in Table 1, tempered with anticipated changes over the near term. The economic data provides support for growth rates generally in the range of two to four percent annually, based growth in employment, population, air passenger volumes, and room taxes. These growth rates are applied uniformly to both the mid-scale and upscale submarkets.
  - Our projections of underlying growth in demand include growth in the commercial segment of 2.0 percent annually throughout the projection period. Growth in the commercial segment is based on employment growth, declining construction activity over the mid-term, and modest contribution from anticipation and optimism surrounding a possible gas pipeline in future years.
  - Within the group demand segment, growth is projected at 1.0 percent annually throughout the projection period. This level of growth is exclusive of continuation of AFN rotations that are presumed to occur in future years.
  - Leisure demand is projected to grow at 0.0 percent annually during the early years of the projection period, gradually increasing to 2.0 percent annually by the end of our projection period. This estimate reflects anticipated flattening of demand patterns in this segment during the early years of the projection period as indicated by tour operators.
  - Within the contract demand segment growth is projected at 0.0 percent annually throughout the projection period, reflecting no significant changes in the key support industries within this segment.

- ◆ Unsatisfied demand is projected based on 75 fill nights annually at a 75 percent occupancy rate for the two new nationally-branded hotels projected to enter the market. This demand is allocated equally to the commercial and leisure demand segments.
  
- ◆ Our estimates of induced demand reflect a negative inducement of roundly 23,000 room nights of military demand from the commercial/government demand segment in 2008. AFN demand is reflected based on an assumed six fill nights during each alternating future year. A corresponding level of demand is extracted during even numbered years when AFN is presumed to be held in Anchorage. This adjustment is applied uniformly to the mid-scale and upscale submarkets. Total AFN influence is estimated at roundly 10,000 occupied room nights in 2007. Our projections also include approximately 5,000 room nights of negative induced demand, allocated equally between 2009 and 2010 that is expected to be drawn away from the Fairbanks market by the projected opening of the new convention center in Anchorage. Lastly, our estimates include roundly 5,500 room nights annually in 2009 and 2010 that are expected to shift from the upscale segment to the mid-scale segment as a result of the new nationally branded hotels opening in the mid-scale segment during future years.

Table 5, presented on the following page, sets forth our projections of growth in demand throughout the forecast period.

<b>Table 5</b>						
<b>Projected Demand Growth by Segment</b>						
	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	
<b>Mid-Scale Market</b>						<b>Mix</b>
Commercial Demand	42,200	49,100	54,000	55,100	56,200	34%
Underlying Growth	2.0%	2.0%	2.0%	2.0%	2.0%	
Unsatisfied Demand	1,700	3,300	1,200	0	0	
Induced Demand	(16,000)	2,750	2,750	0	0	
Group Demand	15,400	20,000	15,800	20,700	16,200	10%
Underlying Growth	1.0%	1.0%	1.0%	1.0%	1.0%	
Unsatisfied Demand	0	0	0	0	0	
Induced Demand	(3,750)	4,400	(4,400)	4,700	(4,700)	
Leisure Demand	71,700	77,800	82,500	83,700	85,400	51%
Underlying Growth	0.0%	0.0%	1.0%	1.5%	2.0%	
Unsatisfied Demand	1,700	3,300	1,200	0	0	
Induced Demand	0	2,750	2,750	0	0	
Contract Demand	7,800	7,800	7,800	7,800	7,800	5%
Underlying Growth	0.0%	0.0%	0.0%	0.0%	0.0%	
Unsatisfied Demand	0	0	0	0	0	
Induced Demand	0	0	0	0	0	
Total Demand	137,000	155,000	160,000	167,000	166,000	100%
<b>Upscale Market</b>						<b>Mix</b>
Commercial Demand	46,800	45,000	43,200	44,100	45,000	19%
Underlying Growth	2.0%	2.0%	2.0%	2.0%	2.0%	
Unsatisfied Demand	0	0	0	0	0	
Induced Demand	(6,800)	(2,750)	(2,750)	0	0	
Group Demand	39,200	43,400	35,000	41,700	35,800	15%
Underlying Growth	1.0%	1.0%	1.0%	1.0%	1.0%	
Unsatisfied Demand	0	0	0	0	0	
Induced Demand	(6,300)	3,800	(8,800)	6,300	(6,300)	
Leisure Demand	135,000	132,300	130,900	132,900	135,600	58%
Underlying Growth	0.0%	0.0%	1.0%	1.5%	2.0%	
Unsatisfied Demand	0	0	0	0	0	
Induced Demand	0	(2,750)	(2,750)	0	0	
Contract Demand	16,200	16,200	16,200	16,200	16,200	7%
Underlying Growth	0.0%	0.0%	0.0%	0.0%	0.0%	
Unsatisfied Demand	0	0	0	0	0	
Induced Demand	0	0	0	0	0	
Total Demand	237,000	237,000	225,000	235,000	233,000	100%
<b>Overall Market</b>						
Commercial Demand	24%	24%	25%	25%	25%	
Group Demand	15%	16%	13%	16%	13%	
Leisure Demand	55%	54%	55%	54%	56%	
Contract Demand	6%	6%	6%	6%	6%	
Total Demand	100%	100%	100%	100%	100%	

Table 6, 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 Fairbanks market. Collectively, our estimates of unsatisfied, induced, and underlying demand growth indicate a 1.6 percent average annual increase in demand for the overall market from 2008 through 2012. This rate of demand growth is substantially below the historical rates of demand growth achieved by the market in recent years, although this was a period marked by considerable changes in supply and other anomalies in demand that are not expected to be repeated in future years. Overall, we consider our projection to be reasonable given the highly unique dynamics of the Fairbanks market.

Based on this analysis, our projections of future market conditions in the mid-scale submarket indicate that occupancy rates will decline substantially in 2008 to 60 percent as a result of the lack of military demand, the continued stabilization of the Alpine Lodge, and the opening of the Holiday Inn Express. Further declines are projected in 2009 and 2010, with occupancies falling to a low of 56 percent in 2010 as the mid-scale sub-market grapples with the third new hotel opening in as many years. Occupancies are projected to gradually rebuild in later years as the new assets begin to stabilize, reaching 58 percent in 2012, a presumed non-AFN year. Similarly, our projection of future market conditions in the upscale submarket indicate occupancy rates are expected to decline roundly three percentage points in 2008 to 62 percent. Continued slippage in occupancies is projected in subsequent years, falling to a low of 59 percent in 2010 as the newer mid-market hotels gradually siphon off demand from the upscale submarket. Gradual rebuilding is projected in later years with the upscale submarket reaching 61 percent occupancy by the end of our projection period.

Table 6 Historical and Projected Market Conditions										
Historical Market Conditions					Projected Market Conditions					
2003	2004	2005	2006	2007		2008	2009	2010	2011	2012
					<b>Mid-Scale Market</b>					
447	515	549	549	627	Existing Product	562	562	562	562	562
					Holiday Inn Express	60	115	115	115	115
					Hampton Inn	0	59	101	101	101
447	515	549	549	627	Average Daily Rooms	622	736	778	778	778
163,155	188,145	200,385	200,385	228,905	Annual Room Nights	226,865	268,719	284,049	284,049	284,049
	15.3%	6.5%	0.0%	14.2%	Percentage Change	-0.9%	18.4%	5.7%	0.0%	0.0%
91,300	110,000	121,900	126,800	152,200	Market Demand	137,000	155,000	160,000	167,000	166,000
	<b>CAAGR</b>	Supply		8.8%			<b>CAAGR</b>	Supply chg.	5.8%	
	<b>CAAGR</b>	Demand		13.6%			<b>CAAGR</b>	Demand chg.	4.9%	
3,141	18,700	11,900	4,900	25,400	Change from prior year	(15,200)	18,000	5,000	7,000	(1,000)
	20.5%	10.8%	4.0%	20.0%	Percentage Change					
0	3,900	1,900	0	4,400	Unsatisfied Demand	3,400	6,500	2,400	0	0
0	0	0	4,600	16,000	Induced Demand	(19,750)	9,900	1,100	4,700	(4,700)
3,141	14,800	10,000	300	5,000	Underlying Growth	1,150	1,600	1,500	2,300	3,700
	16%	9%	0%	4%	Underlying Growth Rate	0.8%	1.2%	1.0%	1.4%	2.2%
56%	58%	61%	63%	66%	Occupancy	60%	58%	56%	59%	58%
					<b>Upscale Market</b>					
781	937	1,052	1,052	1,052	Existing Product	1,052	1,052	1,052	1,052	1,052
					Proposed hotels	0	0	0	0	0
781	937	1,052	1,052	1,052	Average Daily Rooms	1,052	1,052	1,052	1,052	1,052
285,065	341,897	384,001	384,001	384,001	Annual Room Nights	384,001	384,001	384,001	384,001	384,001
	19.9%	12.3%	0.0%	0.0%	Percentage Change	0.0%	0.0%	0.0%	0.0%	0.0%
161,100	200,500	207,900	224,100	248,800	Market Demand	237,000	237,000	225,000	235,000	233,000
	<b>CAAGR</b>	Supply chg.		7.7%			<b>CAAGR</b>	Supply chg.	0.0%	
	<b>CAAGR</b>	Demand chg.		11.5%			<b>CAAGR</b>	Demand chg.	-0.4%	
(4,452)	39,400	7,400	16,200	24,700	Change from prior year	(11,800)	0	(12,000)	10,000	(2,000)
	24.5%	3.7%	7.8%	11.0%	Percentage Change					
0	14,800	6,500	0	0	Unsatisfied demand	0	0	0	0	0
0	0	0	2,000	6,800	Induced Demand	(13,100)	(1,700)	(14,300)	6,300	(6,300)
(4,452)	24,600	900	14,200	17,900	Underlying Growth	1,300	1,700	2,300	3,700	4,300
	15%	0%	7%	8%	Underlying Growth Rate	0.5%	0.7%	1.0%	1.6%	1.8%
57%	59%	54%	58%	65%	Occupancy	62%	62%	59%	61%	61%
					<b>Overall Market</b>					
1,228	1,452	1,601	1,601	1,679	Average Daily Rooms	1,674	1,788	1,830	1,830	1,830
448,220	530,042	584,386	584,386	612,906	Overall Market Supply	610,866	652,720	668,050	668,050	668,050
	18%	10%	0%	5%	Supply Growth	0%	7%	2%	0%	0%
252,400	310,500	329,800	350,900	401,000	Overall Market Demand	374,000	392,000	385,000	402,000	399,000
	23%	6%	6%	14%	Demand Growth	-7%	5%	-2%	4%	-1%
	<b>CAAGR</b>	Supply chg.		8.1%			<b>CAAGR</b>	Supply chg.	2.3%	
	<b>CAAGR</b>	Demand chg.		12.3%			<b>CAAGR</b>	Demand chg.	1.6%	
56%	59%	56%	60%	65%	Occupancy	61%	60%	58%	60%	60%

### Average Room Rates

In analyzing the Fairbanks 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. As a result, while the upscale properties command a moderate premium in room rates during the peak season, there is little difference in room rates between the upscale and mid-scale properties during shoulder or off-peak periods. Furthermore, because the larger, tour-oriented properties in the market focus almost exclusively on packaged leisure demand during peak season, they can often alienate demand in other segments. During shoulder

and off-peak periods, the larger hotels position themselves to recapture this demand by offering more aggressive pricing discounts. Given the generally superior quality of their facilities, this tactic results in an un-level competitive playing field where the lesser quality properties are at a distinct disadvantage. As long as the better quality hotels in the market continue to aggressively discount during off-peak periods, rate growth in the market will remain stifled and the more modest quality properties will be largely ineffective competitors during these periods. While we anticipate that the newer hotels with their stronger brand recognition and loyalty programs will be impacted somewhat less by this practice, the rate-ceiling in the market is likely to continue to be established by the Westmark and Princess hotels.

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 that change depend on a myriad of forces operating within the market and the response to these forces by the individual operators. During the 2003 to 2007 period, average room rates essentially grew at inflationary levels in the Fairbanks market. The mid-scale submarket posted stronger growth during this period than did the upscale market, although this growth was clouded by the opening a new hotel and the renovation and repositioning of another. In contrast, rate growth in the upscale submarket was less influenced by material changes to product quality or timing of new inventory. Overall, we anticipate a continuation of this trend in future years, with the mid-scale submarket achieving stronger growth than the upscale submarket due to the opening of two new, nationally branded, hotels.

To derive a five-year projection of growth in 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 softening economy, flattening of growth in the cruise and tour industries, and the new rooms entering the Fairbanks market in future years. We project growth in average room rates within the overall market at roundly 2.3 percent annually over the projection period, reflecting a modest slowing of growth from recent years. We project the mid-scale submarket will achieve rate growth averaging 3.1 percent annually during the projection period, compared to 2.2 percent annually in the upscale submarket. Our projections of growth in average room rate for each submarket are shown in the following table. The resulting average room rate for the overall market is the weighted average reflecting demand patterns and rates within the two submarkets.


<b>Table 7</b>						
<b>Projected Average Room Rate And Revenue Per Available Room</b>						
<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>
<b>2007</b>						
Midscale Submarket				\$102.00	66%	\$67.82
Upscale Submarket				\$121.00	65%	\$78.40
Overall Market				\$114.00	65%	\$74.59
<b>2008</b>						
Midscale Submarket	2.50%	1.00%	3.50%	\$106.00	60%	\$64.01
Upscale Submarket	2.50%	-0.50%	2.00%	\$123.00	62%	\$75.91
Overall Market				\$117.00	61%	\$71.63
<b>2009</b>						
Midscale Submarket	2.50%	1.00%	3.50%	\$110.00	58%	\$63.45
Upscale Submarket	2.50%	-0.50%	2.00%	\$125.00	62%	\$77.15
Overall Market				\$119.00	60%	\$71.47
<b>2010</b>						
Midscale Submarket	2.50%	1.00%	3.50%	\$114.00	56%	\$64.21
Upscale Submarket	2.50%	-0.50%	2.00%	\$128.00	59%	\$75.00
Overall Market				\$122.00	58%	\$70.31
<b>2011</b>						
Midscale Submarket	2.50%	0.50%	3.00%	\$117.00	59%	\$68.79
Upscale Submarket	2.50%	0.00%	2.50%	\$131.00	61%	\$80.17
Overall Market				\$125.00	60%	\$75.22
<b>2012</b>						
Midscale Submarket	2.50%	0.00%	2.50%	\$120.00	58%	\$70.13
Upscale Submarket	2.50%	0.00%	2.50%	\$134.00	61%	\$81.31
Overall Market				\$128.00	60%	\$76.45
Source: Kennedy & Mohn, P.S.						

## CONCLUSION

Based on our current analysis, the Fairbanks lodging market has performed remarkably well in recent years due to several factors including; the improving quality of the guestroom base in the market, several strong years of growth in cruise/tour demand, the recurrence of AFN, and a significant one-time influx of military demand. However, when projecting performance of the market in future years, several of these factors are expected to absent, thereby causing a moderate softening in projected performance levels in future years. While we do not anticipate any further shifts in the guestroom inventory from year-round to seasonal operations, the continually improving quality of the year-round guestroom base in Fairbanks will likely make it impossible for any of the existing seasonal hotels to shift back to year-round operations. Barring a major announcement regarding a definite gas-pipeline project, we expect the next several years to be a period of retrenchment in the local market. The existing hotels in the market will be forced to compete with several newer assets from two of the strongest national hotel brands on the market. Ultimately, this heightened level of competition will be beneficial for the market as a whole, although it may be increasingly painful for those properties with more dated facilities or modest quality.

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 Fairbanks. 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.

By: Michael J Mohn, MAI  
Certified General Real Estate Appraiser  
Alaska License # 221

MJM:tpk



## **GENERAL ASSUMPTIONS**

This market overview study 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**

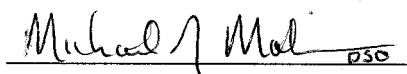
This market overview study has been prepared under the following general limiting conditions:

- ◆ 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.
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- ◆ 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 study is for AIDEA's internal use in evaluating future hotel financing requests within the state.
- ◆ 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 MAI

Michael J. Mohn, MAI

CCERT Ver.5/2005