



HOTEL FEASIBILITY STUDY

Northfield, Minnesota

October 2015

Prepared for:

Northfield Economic
Development Authority

The logo for Hospitality Consulting Group features the word "Hospitality" in a large, black, serif font. Above the letters "i" and "t" is a green curved line that arches over the text. Below "Hospitality" is the phrase "CONSULTING GROUP" in a smaller, green, sans-serif, all-caps font.

Hospitality

CONSULTING GROUP

Mr. Christopher Heineman
Community Planning & Development Director
801 Washington Street
Northfield, MN 55057

Dear Mr. Heineman:

The Hospitality Consulting Group is pleased to present the accompanying report entitled: "Hotel Feasibility Study–Northfield, Minnesota" which has been prepared in accordance with our engagement letter dated July 20, 2015.

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

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

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

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

Our report is intended solely for the information of the Northfield Economic Development Authority for use in encouraging the development of a new hotel in the community. It may also be used to obtain funding the recommended hotel. Otherwise, neither the report nor its contents, nor any reference to our Firm may be referred to or quoted in any registration statement, sales brochure, prospectus, loan, appraisal or other agreement or document without our prior written consent.

October 9, 2015

HOSPITALITY CONSULTING GROUP, INC.

DRAFT

HOTEL FEASIBILITY STUDY NORTHFIELD, MINNESOTA

Letter of Transmittal

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SECTION 1: INTRODUCTION

BACKGROUND

Northfield is a growing community located on the southern edge of the Minneapolis-St. Paul metropolitan area. The city is anchored by two prestigious colleges and has a strong commercial/industrial base. Activities at the colleges create numerous occasions where the local hotels are completely sold out, forcing visitors to seek lodging in surrounding communities. Also, local business owners and visitors to the community have expressed a desire for higher quality lodging accommodations. Having recognized this situation the City's Economic Development Authority is interested in evaluating the feasibility of a new hotel to serve the community.

Hospitality Advisors has extensive experience working with hotel developments throughout the United States. We were retained to research the market support for the new hotel, recommend the scope of facilities appropriate for the market, develop estimates of utilization, prepare financial projections, and evaluate the economic feasibility of a new hotel. The scope of our work in conjunction with this engagement is summarized below.

SCOPE OF WORK

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

- Determination of the primary market area and evaluation of pertinent demographic and economic information;
- Identification of likely sources of lodging demand;
- Interviews with local businesses;
- Identification and evaluation of competitive lodging facilities;

- Projection of the lodging demand that a new hotel could reasonably expect to capture;
- Projection of the average daily rate and levels of utilization the hotel could expect to achieve in its first five years of operation;
- Financial projections for the recommended hotel's first five years of operation;
- Preliminary economic feasibility evaluation based on project cost and financing terms assumptions; and
- Preparation of this final report documenting our findings, conclusions, recommendations, and financial projections for the hotel.

DRAFT

SECTION 2: EXECUTIVE SUMMARY

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

Project Description

Northfield is a growing community located on the southern edge of the Minneapolis-St. Paul metropolitan area. Activities at the colleges create numerous occasions where the local hotels are completely sold out, forcing visitors to seek lodging in surrounding communities. Also, local business owners and visitors to the community have expressed a desire for higher quality lodging accommodations. Having recognized this situation the City's Economic Development Authority is interested in evaluating the feasibility of a new hotel to serve the community.

Local Market Conditions

The population of Northfield increased by nearly 17 percent over the last decade and presently has a population of around 20,400. The size of Northfield's potential hotel market is limited by the proximity of the surrounding cities of Faribault, Apple Valley, Hastings, and Red Wing. The primary market area encompasses a 15-minute drive time surrounding Northfield. The local economy benefits from two prestigious private colleges, several large manufacturers, and tourism drawn by historic downtown Northfield. Highway access is excellent with direct access to the Twin Cities by U.S. Highway 3 and Interstate 35.

Hotel Supply

The Northfield lodging supply is made up of four hotels, one motel, and a small inn with a total of 214 guest rooms. Only three of the hotels, with a total of 131 rooms, would be considered to be competitive with a new hotel. The full service, 132-room Holiday Inn & Suites in nearby Lakeville would also be considered to be somewhat competitive with a new hotel.

Hotel Demand

A new hotel in Northfield would capture local commercial, leisure and college-related lodging demand. St. Olaf College and Carleton College are the largest generators of lodging demand, accounting for approximately one third of the total hotel business.

Data obtained from the Minnesota Lodging Association for Southern Minnesota showed that the amount of hotel demand accommodated in the region has steadily increased since the low point of the recession felt in 2009, and occupancy has nearly returned to the pre-recession level. Lodging demand increased by 4.2 percent last year and is up 4.4 percent over the first eight months of this year. This data shows that the hotel supply in the Minnesota South region achieved an overall annual occupancy of 52 percent in 2014 with an average daily room rate of nearly \$79.

We estimate that the market experiences about 70 capacity nights a year, almost all of which occur on weekends. These are a result of college events and local social gatherings. We also found that a substantial amount of commercial demand (estimated to be 1,700 roomnights) is leaving the market to find higher quality and/or quieter (no train noise) lodging accommodations.

The additional room capacity provided by a new hotel will allow the market to accommodate more demand on nights when college events and local events fill the available hotel rooms. By capturing this demand, as well as the commercial demand that leaves the market, we estimate that a new high quality franchised hotel could attract approximately 6,000 annual roomnights back to the Northfield market. This represents an increase of 21 percent in the demand currently being accommodated by the competitive supply.

Proposed Facilities

Based on our analysis of the lodging demand that exists in the area, we believe that a 60-room upper midscale limited service hotel with a strong franchise can be market supported in Northfield. We suggest the hotel should have a significant number of suites which are popular with leisure travelers. Additional amenities should include: a public function room of between 500 and 800 square feet; an indoor pool; an exercise room; a business center; and complimentary breakfast for guests. The hotel should be adequately soundproofed to block out train noise from the nearby railway and should have at least 60 parking spaces for its guests.

Site Review

The hotel site identified by the Economic Development Authority is located along the Cannon River in the northwest quadrant of the intersection of Highway 3 and 2nd Street West.

Based on our review of the site, we consider it to be excellent for a hotel development. Its competitive advantages include proximity to the two colleges and to the down town area. It is also has good acces to the major employers and there are a variety of restaurants in the immediate area

Projected Occupancy

Based on the community's projected population growth and assumed continued improvement in the area economy, we have assumed an annual 1.0 percent growth in the area's base lodging demand. In addition to this growth, the new hotel will capture demand that is presently leaving the market. The additional room capacity provided by a new hotel will allow the market to accommodate more demand on nights when college events and local events fill the available hotel rooms. By capturing this demand, as well as the commercial demand that leaves the market, we estimate that a new high quality franchised hotel could attract approximately 6,000 annual roomnights back to the Northfield market. This represents an increase of 21 percent in the demand currently being accommodated by the competitive supply

Based on the results of our market study, we estimate that a new hotel would be able to capture a premium above its fair share of the primary market demand. By calculating the ratio of the rooms available at the proposed hotel

to the total number of rooms available within the market, the “fair share” percentage of demand for the hotel may be determined. The fair share calculation reflects the market share that the hotel could expect to capture if all available rooms in the market were favored equally by potential guests and choices were made on a purely random basis. The recommended 60 rooms represents 31.4 percent of the competitive supply (60/191 = 31.4 %). Our analysis found that the hotel can expect to achieve a market share that has a 15 percent premium over its fair share of the base demand. When the recaptured commercial demand is added to the hotel’s business, its premium over fair share increases to 32 percent.

The results of our utilization analysis are presented in the following table, which show the subject hotel achieving projected occupancies that range from 58 percent in its first year to 64 percent in its fifth year, with its market share stabilizing in its third year.

**Northfield Hotel
Projected Market Mix and Occupancy
60 Rooms**

Market Segment	2017	2018	2019	2020	2021
Commercial	4,900	5,800	6,000	6,100	6,100
Leisure Travelers	3,300	3,300	3,400	3,400	3,500
College	4,400	4,400	4,400	4,400	4,400
Total Occupied Rooms	12,600	13,500	13,800	13,900	14,000
Available Rooms	21,900	21,900	21,900	21,900	21,900
Annual Occupancy	58%	62%	63%	63%	64%

Average Daily Room Rate

The analysis from which we developed our projections of average daily rate for the proposed hotel included the quality and pricing structure of the other area hotels. The estimated average rates at the four competitive hotels range between \$100 and \$120. Based on our analysis, we have determined that an upper midscale limited service hotel should be able to achieve an average rate of \$130 expressed in current dollars.

Factored into the room rates projected for the subject hotel are an inflation factor of 2 percent and a real growth factor of 1 percent, for a total increase of 3 percent annually. The inflated average rate in 2017, the hotel’s first full year of operation, is projected to be \$137.92.

Financial Projection Summary

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

FINANCIAL PROJECTION SUMMARY					
60 ROOM HOTEL					
	2017	2018	2019	2020	2021
Occupancy	58%	62%	63%	63%	64%
Average Daily Rate	\$137.92	\$142.05	\$146.32	\$150.71	\$155.23
Total Revenue	\$1,765,433	\$1,947,876	\$2,050,477	\$2,126,868	\$2,205,999
Departmental Expenses	(452,033)	(493,709)	(515,790)	(531,416)	(547,507)
Undistributed Expenses	(521,738)	(560,219)	(582,443)	(599,377)	(616,810)
Management Fee	(70,617)	(77,915)	(82,019)	(85,075)	(88,240)
Fixed Charges	(77,230)	(138,371)	(162,592)	(187,850)	(193,066)
Cash Flow For Debt Service	\$643,814	\$677,661	\$707,633	\$723,151	\$760,376

Economic Feasibility Analysis

For purposes of analysis, Hospitality Consulting Group assumed the hotel to have a total cost of \$7,500,000, or \$125,000 per guest room.

The financing terms utilized in the analysis assumed an equity investment of \$1,470,000, leaving a loan of \$3,430,000 to provide funds for the \$4,900,000 total project cost.

Source of Funds:

Equity	\$1,875,000	25%
Debt	<u>5,625,000</u>	<u>75%</u>
	\$7,500,000	100%

Debt Term Assumptions:

Annual Interest Rate:	5.0%
Amortization:	20 years
Annual Payment:	\$445,470

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

60 Room Hotel- Northfield, MN					
Economic Feasibility Analysis					
Estimated Project Cost: \$7,500,000					
	2017	2018	2019	2020	2021
Cash Flow Available for Debt Service	\$643,814	\$677,661	\$707,633	\$723,151	\$760,376
Debt Service	\$445,470	\$445,470	\$445,470	\$445,470	\$445,470
Debt Service Coverage	1.4X	1.5X	1.6X	1.6X	1.7X
Cash Flow to equity	\$198,344	\$232,191	\$262,163	\$277,681	\$314,905
Equity	\$1,875,000	\$1,875,000	\$1,875,000	\$1,875,000	\$1,875,000
Return on Equity	10.6%	12.4%	14.0%	14.8%	16.8%

A debt coverage ratio (cash flow/annual debt service) of a minimum of 1.2 times is required and 1.4 times is typically preferred by lenders. This analysis shows that the hotel is projected to generate sufficient cash flow to meet its debt service requirements. Also, in this simple analysis, the projected cash on cash return on equity is 14 percent or greater once the hotel reaches its stabilized level of operation.

Hotel investors typically like to see cash on cash returns of at least 10 percent, although local investors may accept a slightly lower return in order to bring a new hotel to the community. Also, a hotel development company, who also would manage the hotel, may include the management fee in its investment decision.

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

SECTION 3: REGIONAL CHARACTERISTICS

INTRODUCTION

The following section provides an overview of Northfield’s lodging market environment. Included within this section is a review of selected economic and demographic data, along with descriptions of the transportation infrastructure, tourism and attractions in the area.

LOCATION

The City of Northfield is located in south central Minnesota on the northern border of Rice County, approximately 40 miles south of both downtown Minneapolis and downtown St. Paul.

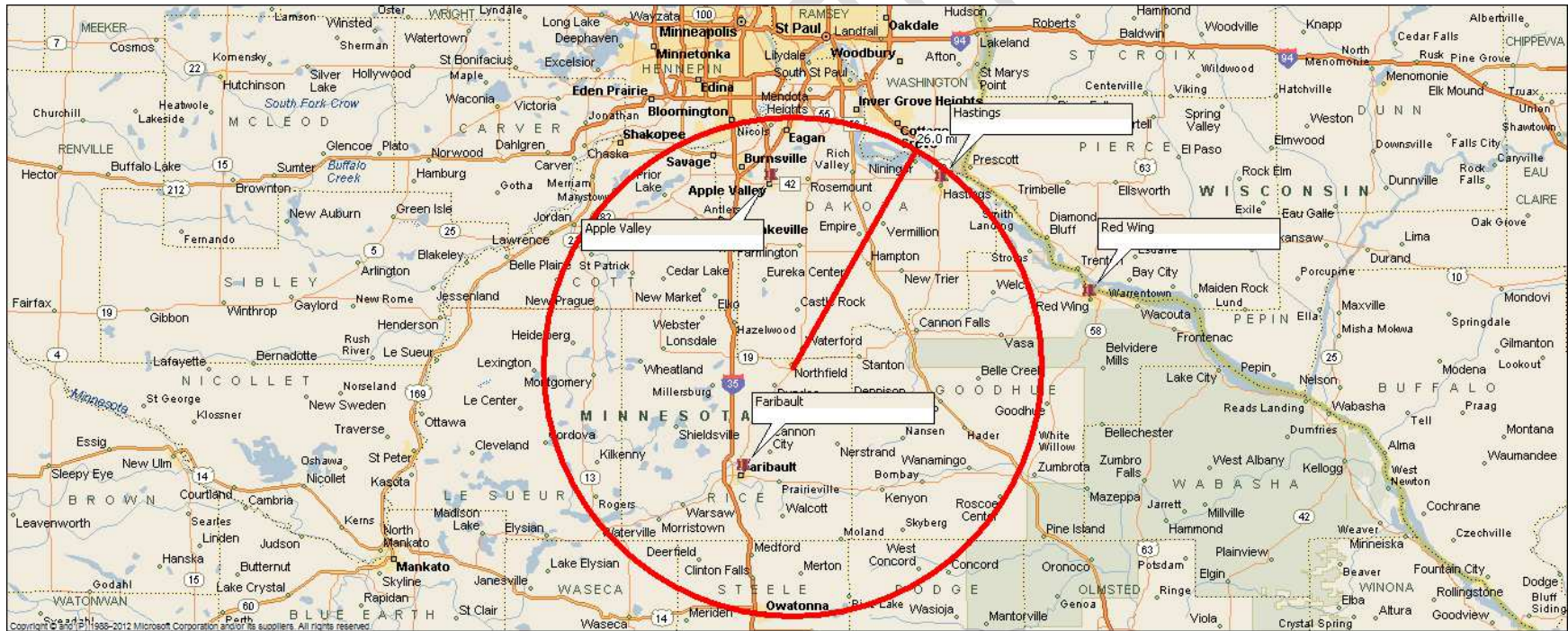
Northfield’s location on U.S. Highway 3 provides for easy access to the southeastern suburbs of the Twin Cities, and Interstate 35 provides convenient access to both Minneapolis and St. Paul. Thus, Northfield draws commuters who wish to live in a rural college town environment. Both the retail and the hotel markets are limited by the proximity of the surrounding communities of Apple Valley, Faribault, Red Wing, and Hastings, all located within about 25 miles. Northfield’s location is shown on the map on the following page.

Most of Northfield is located in Rice County with some northern neighborhoods lying in Dakota County. Dakota County is one of the 11 counties that comprise the Minneapolis-St. Paul Metropolitan Area that has a population of 3.4 million.

DEMOGRAPHICS

Population data for Northfield, Rice County, and Dakota County are presented in the table below. Between 2000 and 2010, the population of Northfield increased by 16.7 percent, representing a compound annual average growth rate of 1.5 percent.

Northfield Location



This rate of growth exceeded the 1.2 percent compound growth rate experienced by Rice County during the last decade and exceeded the 0.8 percent overall state growth rate for that period.

Population Trends

	2000	2010	Compound Annual Growth	Estimated 2014
Northfield	17,147	20,017	1.5%	20,356
Rice County	56,665	64,142	1.2%	65,151
Dakota County	357,906	399,151	1.1%	412,529
Minnesota	4,919,479	5,303,925	0.8%	5,453,218

Source: U.S. Census

Lesser growth rates are projected for the period between 2010 and 2025. During this time, the population of Rice County is expected to increase at a compound average annual rate of 0.6 percent, a rate that is smaller than the overall projected state growth rate of 0.8 percent.

Population Growth Projections

	2010(1)	2025(2)	Compound Annual Growth
Rice County	64,142	68,965	0.6%
Dakota County	399,151	456,100	0.9%
Minnesota	5,303,925	5,843,644	0.8%

Source: 1. U.S. Census

2. Minnesota State Demographic Center

Household Incomes

The median household income for Northfield, Rice County, Dakota County, and the State of Minnesota are shown in the following table. The median is the midpoint at which there are an equal number of households with larger and smaller incomes. The median household income in Northfield is 1 percent lower than the median for the state and the median household income in Rice County is 1 percent above the statewide median.

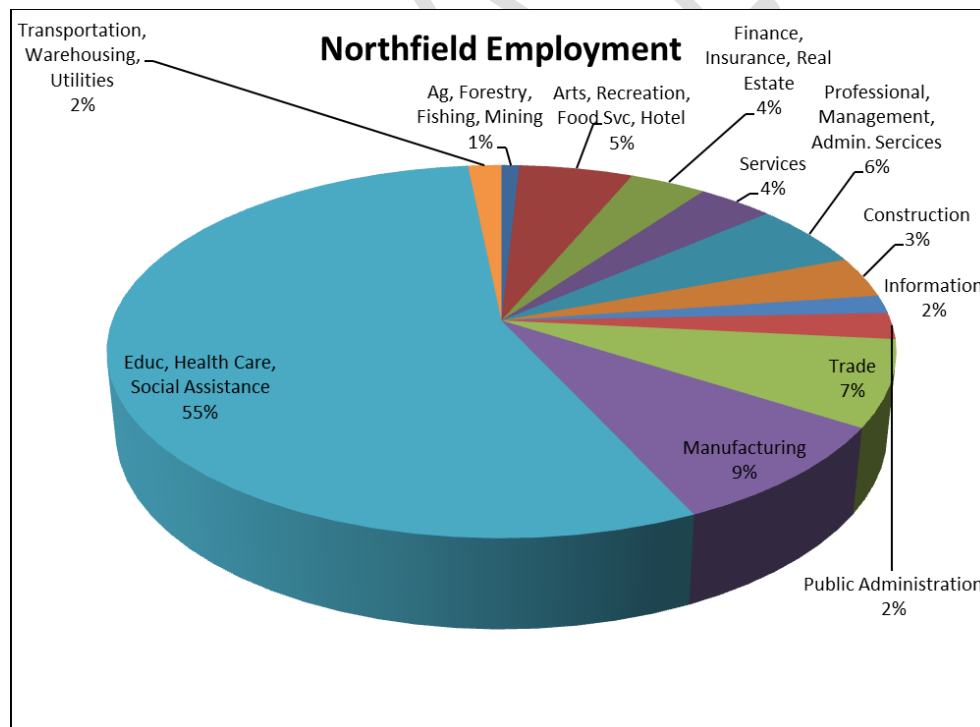
**Median Household Income
2010**

Northfield	\$59,233
Rice County	\$59,915
Dakota County	\$73,732
Minnesota	\$59,863

Source: U.S. Census

EMPLOYMENT

Employment is a strong indicator of an area’s economic health. The city’s employment is dominated by the two colleges, which results in an extremely stable employment base. There is also a fairly large manufacturing employment base (9%) as well. Manufacturing is typically a strong generator of lodging demand with vendors, customers, and sales meetings that draws people who require lodging accommodations.



Source: U.S. Census 2013

Industrial Parks

Northfield has three established industrial parks and a fourth awaiting development:

Riverview Enterprise Park is located southeast of downtown along Highway 3. This 250-acre park is nearly fully developed, with only a few vacant acres left.

Armstrong Enterprise Park is located southeast of downtown along Highway 19. There are approximately 50 acres available for development in this 175-acre park.

North Highway 3 Enterprise Park is located north of downtown along Highway 3. There are approximately eight acres left for development in this approximately 45-acre park, with additional land available through annexation.

Northwest Enterprise Park is located west of downtown along Highway 19. This 500-acre parcel was annexed in 2009 and remains undeveloped.

Major Employers

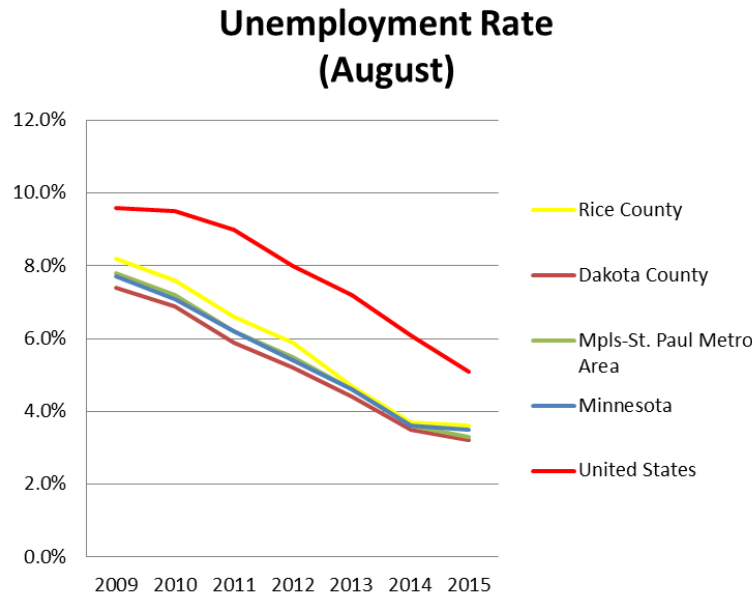
Northfield has a diverse economy with concentrations in high tech, bio-tech and educational industries. Some of the community’s largest employers are listed below.

Major Northfield Employers

<u>Company</u>	<u>Product / Service</u>	<u>Employees</u>
MOM Brands	Cereal manufacturing & distribution	
Multec Flexible Circuits	Electronic circuit board manufacturing	
McClane Company	Wholesale grocery distribution	
Aurora Pharmaceutical	Veterinary supplies	
Cardinal Glass	Residential window glass manufacturing	
Northfield Hospital	Health Care	
St. Olaf Colege	Education	
Carleton College	Education	

Unemployment

The unemployment rate in Rice County as of August 2015 was 3.6 percent, a level that is only slightly higher than the Minnesota statewide rate of 3.5 percent. Minnesota’s unemployment rate is among the lowest in the nation.



Source: U.S. Bureau of Labor Statistics

HIGHWAYS

Northfield is located at the intersection of Minnesota Highways 19 and 3. Minnesota Highway 19 is an east-west route that connects Northfield with Interstate 35 to the west and continues on to the South Dakota border. The highway extends east to Cannon Falls and Red Wing. . Traffic counts taken by the Minnesota Department of Transportation show that an average of 10,800 vehicles utilizes this highway daily west of Northfield and 2,450 vehicles utilize it east of town.

Highway 3 is a north-south route that connects Northfield with Faribault to the south and Farmington, Rosemount, and the I-494 beltway around the Twin Cities to the north. MNDOT traffic counts show that an average of 4,950

vehicles travels this highway daily on the north side of Northfield and 6,600 travel the highway to the south of the city.

Interstate 35 is located seven miles west of Northfield. This major north-south route connects Minneapolis-St. Paul and Duluth to the north with Des Moines and Kansas City to the south.

RESTAURANTS

Restaurants can be an important hotel requirement, particularly for commercial travelers and for local businesses entertaining customers and other visitors. Northfield lacks an upscale table service restaurant; however, it does have a wide variety of dining options. These include American restaurants (such as Applebee's and Perkins), six ethnic restaurants, six pubs/grills, and a number of fast food outlets. We believe that Northfield has sufficient restaurants to meet the needs of most hotel guests.

COLLEGES

There are two colleges in Northfield that are the largest employers in town and generate the most lodging demand.

St. Olaf College

This private liberal arts college was founded in 1874. It is located on a 3,000-acre campus on a hill overlooking Northfield. Several historic buildings remain on campus of which two are on the National Historic Register. The college is regularly ranked among the top 25 small colleges in the United States. The college offers 39 majors and has an enrollment of around 3,000 students, who originate from all 50 states and 73 countries. St. Olaf is recognized for its Music Department which performs a series of popular Christmas concerts in early December each year. The college competes within the NCAA Division III and fields 27 teams.

Carleton College

This private liberal arts college was founded in 1866. It is located on a 1,040-acre campus with a number of historic buildings remaining. *US News & World*

Report ranked Carleton College the eight best colleges in the country and first in undergraduate education. The college offers 36 majors and 15 concentrations. Enrollment is around 2,000 with students from all 50 states and 42 countries. Only around 15 percent of the students are from Minnesota. Carleton competes within the NCAA Division III and fields 18 teams.

AREA ATTRACTIONS

Visitors have numerous reasons to come to Northfield. Two prominent colleges, a historic downtown and a recreational river draw people to Northfield year round.

Historic Northfield

Northfield was founded in the 1850's as a milling center and the town remains along the Cannon River. Many of the buildings in downtown Northfield are well-preserved examples of late 19th and early 20th century architecture. The attractive downtown features restaurants and pubs, bookstores, antique shops, clothing stores, galleries and gift shops. An attractive walk along the river ties downtown to the river and provides the location for the popular Riverwalk Market Fair held on Saturdays throughout the summer and fall. The fair features artists, performers and organic farmers selling their work.

Defeat of Jesse James Days

Northfield holds a heritage festival every year to commemorate the successful defeat of Jesse James and the James-Younger Gang's attempt to rob a bank. The bank's cashier and a bystander were killed in the robbery, as were several gang members. The remainder of the gang was later captured in southern Minnesota, however Jesse James escaped. The bank that was robbed now houses the *Northfield Historical Society and Museum*.

The festival is held the weekend after Labor Day and is among the largest outdoor celebrations in Minnesota, attracting thousands of visitors to witness reenactments of the robbery. Other activities during the festival include a championship rodeo, carnival, car show, parade, arts and crafts expositions, and musical performances.

Mill Towns Trail

The **Mill Towns State Trail** is a multi-use trail in development along the Cannon River. Currently a 3-mile-long rail trail links Northfield and Dundas. The trail is planned to extend southward to Faribault where it will link up with the Sakatah Singing Hills Trail that extends from Faribault to Mankato. The Mill Towns Trail is also planned to extend eastward to Cannon Falls where it will hook up with Cannon Valley Bike Trail. This popular trail is a paved 19.7 mile trail that follows the Cannon River between Cannon Falls and Red Wing. The trail is used for biking, hiking, in-line skating and cross country skiing and requires a \$4 wheel pass. The trail attracts nearly 100,000 visitors a year

Cannon River

The Cannon River flows northeast through Northfield on its way to the Mississippi River at Red Wing. It is a designated Wild and Scenic River. There were once 15 mills located along its path and the remains of several still can be seen. Its flowage, scenic beauty and abundant wildlife combine to make the river extremely popular for canoeing, kayaking and tubing.

Cannon Valley Winery

The Cannon Valley Winery operates a 20-acre vineyard outside of Cannon Falls, approximately 15 miles east of Northfield. The winery has processing equipment and a comfortable tasting room on the first floor of its facility in downtown Cannon Falls, and a large event center on the second floor that it uses for functions. The winery has become extremely popular for weddings, with the ceremony performed at the vineyard in a rustic 150-year old timber frame barn and the reception held at the winery. Weddings are hosted almost every weekend which creates lodging demand. Due to limited hotel accommodations in Cannon Falls, wedding parties seek lodging in the neighboring communities.

SECTION 4: AREA HOTEL SUPPLY

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

HOTEL SUPPLY

The Northfield lodging market consists of four hotels, one motel, and a small inn. Events at the two colleges create a number of nights in which lodging demand exceeds the supply of hotel rooms, resulting in a loss of business to hotels in the surrounding area. In addition, we found that some demand leaves the market in search of hotel accommodations that are newer or higher quality than what is currently available in Northfield.

Northfield Lodging Supply

The total lodging supply in Northfield consists of five hotels/motels and a small inn that combine for a total of 214 rooms. Only three of these properties would be competitive with a new hotel. These lodging facilities are described below.

Archer House River Inn



Constructed in 1877, this French Second Empire hotel is located on the Cannon River in down town Northfield. It has 36 guest rooms of which five are 2-room suites. All rooms have a private bath and a full renovation of the hotel was completed in 2011. Amenities include high speed internet, an exercise room, and a banquet/conference center for up to 100 persons. The first floor of the building is mostly devoted to retail. Tenants include a coffee shop, an Indian restaurant, and two gift shops. A tavern is located on the lower level with a deck that overlooks the river.

This upper midscale hotel benefits from its down town location and proximity to Carleton College three blocks away. It is the market leader in both occupancy and average room rate. We estimate the hotel will achieve an average rate of around \$118 this year.

Country Inn & Suites



This 54-room midscale hotel opened in 1993. Amenities at the hotel include an indoor and whirlpool, but it lacks a fitness room. A hot breakfast is provided to its guests. Seven of its rooms are suites. Meetings can be hosted in the breakfast room which has a capacity of 20 people. Room rates at this upper midscale property during the week are \$ \$110 and suites are \$121 to \$126; a 15 percent discount is offered for non-refundable advance purchase. Due to the high demand generated by the colleges on weekends, rates are generally increased by \$35 to \$40. Weekend bookings typically require a two-night stay. Room rates are generally discounted \$5 during the summer and several winter months. We estimate the hotel will achieve an average rate of around \$109 this year.

An active railroad track passes directly behind the hotel, which is reported to be a concern for repeat guests. Our fieldwork found that some commercial and leisure travelers avoid this hotel because of the train noise. The hotel shows its age but benefits from its location that provides easy access to both colleges.

AmericInn Lodge & Suites



This 41-room midscale hotel opened in 2000. It has a large indoor pool area with a whirlpool, but it lacks a fitness room. A hot breakfast is provided for its guests. Eight of its rooms are suites. Room rates at this midscale property are \$100 to \$105 for regular rooms and \$130 for suites. Room rates increase \$20 on weekends. We estimate the hotel will achieve an average rate of around \$100 this year.

This hotel is the newest lodging facility in Northfield and appears to be in very good condition. Its location about one mile south of the downtown is somewhat inconvenient relative to the other two competitive hotels.

Americas Best Value Inn



This 55-room economy hotel opened in 1985 as a Super 8. Amenities include free breakfast for guests, high speed internet and HBO. This hotel's last reported renovation occurred in 2001. The hotel is in poor condition and is reported to have a large amount of longer stay rentals rather than transient guests. We did not consider this economy hotel to be competitive with a new hotel.

The hotel is located about 1.5 miles south of the downtown along Highway 3. It is the most from the colleges.

There are two other lodging facilities in Northfield that did not consider to be competitive and therefore were not included in our analysis.

The **College City Motel** is a 24-room older motel with outside entrances, located along Highway 3 on the north edge of town. This facility is at least 50 years old and rents almost entirely to weekly or monthly residents. There are several U-Haul vehicles on site as the motel operates a rental business from this location.

Froggy Bottom River Suites is a four-room inn operated in conjunction with a pub located on the west side of the Cannon River in the downtown. The inn has no lobby and keys are obtained at the bar in the pub or from a lockbox. The rooms in the old restored building are large

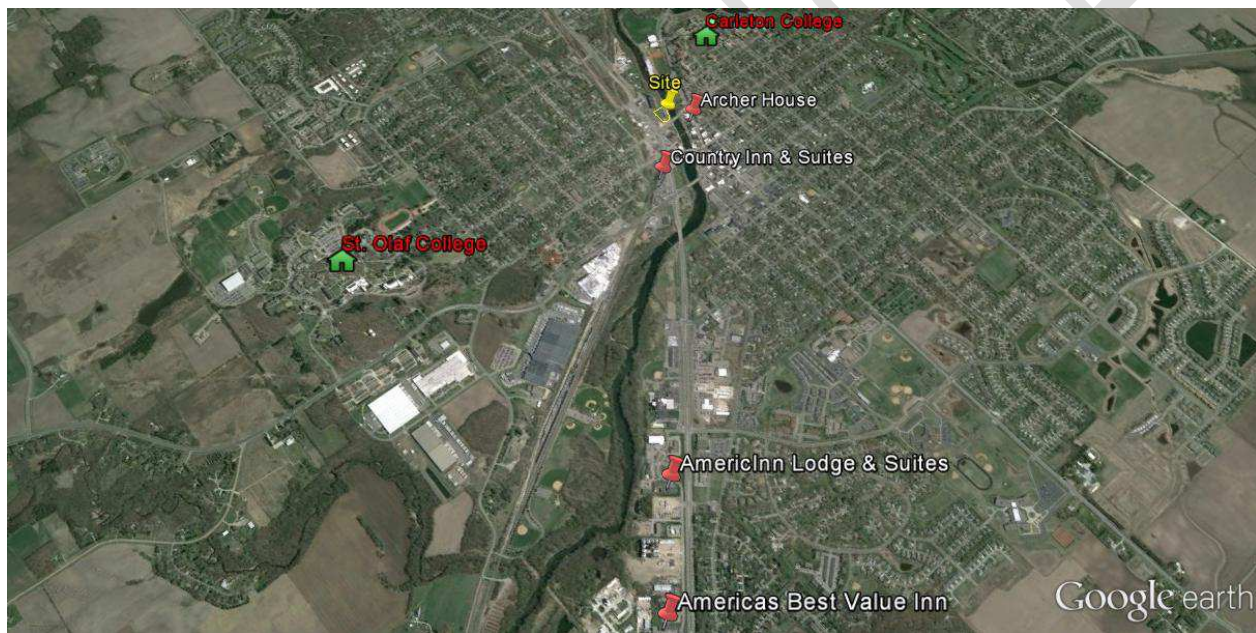
and furnished with miscellaneous used furniture. We believe the inn accommodates overflow business almost exclusively.

Pertinent characteristics of the three competitive properties are summarized below and their locations are shown on the following map.

NORTHFIELD COMPETITIVE HOTELS

Hotel	Quality	Year Opened	Number of Rooms	Room Rates (2015)		Amenities
				Single	Suites	
Archer House River Inn	Upper Midscale	1877	36	\$90-\$130	\$180-\$200	Meeting room (100), 3 restaurants
Country Inn & Suites	Midscale	1993	54	\$110	\$121-\$126	Pool, whirlpool
AmericInn Lodge & Sui	Midscale	2000	41	\$100-\$105	\$130	Pool, whirlpool

Source: STR Global and Hotel websites

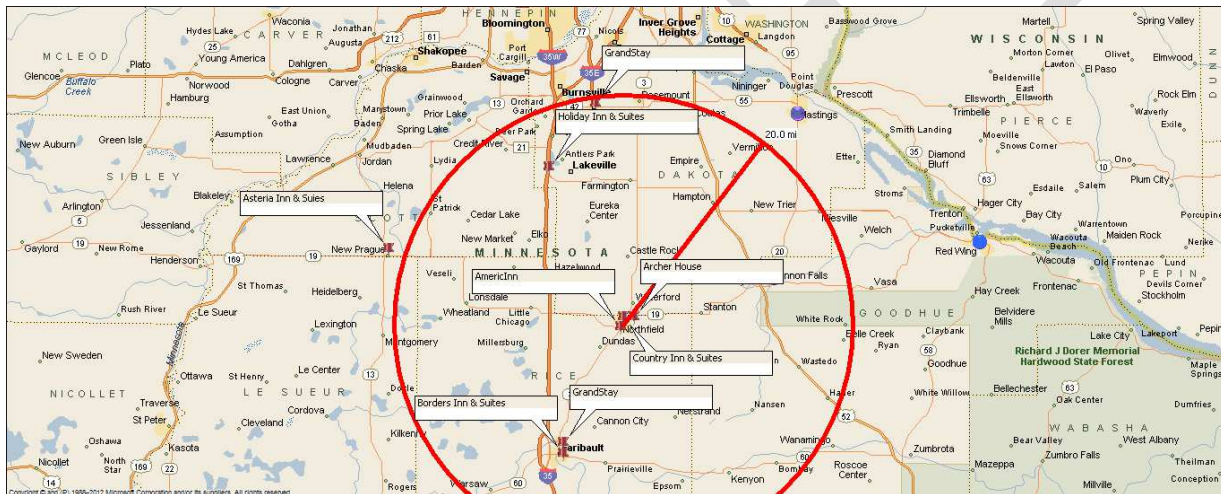


Area Competitive Lodging Supply

The size of the Northfield market is defined by Apple Valley to the north; Hastings, Cannon Falls, and Red Wing to the east; and Faribault to the south. To the west, communities near the Highway 169 corridor generally utilize hotels in Shakopee or Mankato, although there is one upper midscale hotel located on Highway 19 in New Prague, between Northfield and Highway 169.

Our research found that some Northfield lodging demand seeks lodging accommodations at the Holiday Inn in nearby Lakeville and at the Grand Stay Hotel in Apple Valley. The GrandStay Hotel in Faribault was also mentioned as an occasional destination. The locations of these hotels are shown on the following map.

Competitive Area Hotels



Holiday Inn & Suites is located along I-35 in Lakeville, approximately 20 minutes north of Northfield. This 132-room upper midscale hotel opened in 1985 as a Super 8 economy motel, but has been completely renovated and repositioned. It is one of the few full service hotels in the southern metropolitan area. It features a supper club with a lounge and four meeting rooms plus a 4,300-square foot ballroom. Other amenities include an indoor pool with a water slide and a whirlpool. Rack rates during the week are \$135 to \$153 for regular rooms and \$171 to \$190 for suites.

GrandStay Hotel & Conference Center is located approximately 20 minutes north in Apple Valley. This 78-room midscale hotel opened in 2007. It has studio suites that feature a sleeper sofa, full size refrigerator, and a dining area and 1- and 2-room suites with full kitchens and sofa sleepers. Meeting/banquet space consists of 3 meeting rooms and a 3,800-square foot ballroom. Amenities include a free breakfast, indoor pool and whirlpool, exercise room, and an outdoor sport court and grill. Room rates during the week range between \$130 and \$180.

Asteria Inn & Suites is located in New Prague approximately 30 minutes west of Northfield. The 48-room midscale hotel opened as an AmericInn in 1997. It provides a breakfast to guests and amenities include an indoor pool and whirlpool, an exercise room and a small meeting room. Room rates during the week range between \$130 and \$150.

Faribault Lodging Supply

Faribault is a community of over 23,000 that is located 15 miles south of Northfield on Highway 3. It has a substantial corporate base and is located along Interstate 35. Several institutions in the community generate lodging demand:

Shattuck-Saint Mary's is a coeducational boarding school with approximately 424 students that originate from throughout the country. The school is most noted for its hockey program which has produced numerous NHL and Olympic players.

Minnesota State Academies for the Blind and For the Deaf are public residential schools for Minnesota children with special needs.

Minnesota Correctional Facility – Faribault is the largest prison in the state with approximately 2,000 inmates.

The Faribault lodging supply consists of four nationally franchised hotels and two older independent motels. The **GrandStay Residential Suites Hotel**, constructed in 2009, is the newest hotel. All of its suites have full kitchens, which makes the hotel popular with leisure travelers and guests who stay multiple nights. The other potentially competitive hotel is the **Boarders Inn & Suites**, a re-branded hotel that opened in 1994 as an AmericInn. The Faribault hotels accommodate overflow demand when Northfield's hotels are full.

FARIBAULT COMPETITIVE HOTELS

Hotel	Quality	Year Opened	Number of Rooms	Room Rates (Oct. 2015)		Amenities
				Single	Suites	
GrandStay Residential Suites	Midscale	2009	59	\$90	\$110-\$120	Pool, whirlpool, exercise room meeting room
Borders Inn & Suites	Midscale	1994	62	\$85	\$116-\$130	Pool, whirlpool, sauna

Source: Smith Travel Research and Hospitality Consulting Group

Cannon Falls Lodging Supply

Cannon Falls is a community of around 4,000 that is located 15 miles east of Northfield on Highway 19. Its lodging supply consists of one hotel and one motel with a combined total of 59 economy guest rooms. Pertinent characteristics of these properties are summarized below.

CANNON FALLS HOTEL SUPPLY

Hotel	Quality	Year Opened	Number of Rooms	Room Rates (2015)		Amenities
				Regular	Suites	
Saratoga Inn	Economy	1993	43	\$70-\$80	\$85-\$100	Pool, whirlpool
Caravan Motel	Economy	1975	16	\$70-\$80	na	none

Source: STR Global and Hotel websites

The **Saratoga Inn** has an indoor pool and operated as a Best Western through 2014. The hotel is very dated and in need of renovation. The possibility does exist that such an investment could revive it to a midscale property. The **Caravan Motel** is an older facility with a large amount of work crew business and other extended stay guests. Currently, a significant portion of the local lodging demand is lost to hotels in surrounding communities.

MEETING FACILITIES

A community needs public space to accommodate functions such as business meetings, training sessions, seminars, banquets, fund raisers, reunions and receptions. Hotels used to build large and flexible meeting spaces to fulfill these needs. However, the development of large numbers of economy and

limited service hotels that lack food service and meeting space have greatly reduced the number of new full service hotels. As a result, restaurants, golf clubs and banquet halls are capturing increasing shares of this business.

Both colleges have facilities on campus that meet their public assembly and banquet needs. There are two venues in Northfield that can accommodate large group functions, which are described below.

Grand Event Center is located in down town Northfield in a 100-year-old restored auditorium. The facility targets weddings and corporate events for which it provides catering service. Maximum banquet capacity is 300 persons, which requires seating in the balconies as well as on the main floor.

Northfield Ballroom has been operating as a restaurant, bar, and banquet facility since 1981. It targets wedding receptions, graduation parties and other celebrations.

Other than the Grand Event Center, the community lacks a venue that can accommodate conventions or larger association meetings.

SECTION 5: AREA HOTEL DEMAND

HOTEL INDUSTRY TRENDS

As the nation began to slide into a recession in the fourth quarter of 2008, so did the lodging industry. Travel budgets were one of the first expenses cut by businesses in an attempt to maintain profitability in the face of rapidly declining sales as the recession deepened in 2009. Loss of net worth, job loss or fear of job loss, and other economic uncertainties kept many leisure travelers at home, which further impacted the hotel industry. The industry began to recover in the second quarter of 2010 and has continued to improve in every quarter since then. By the end of 2013 most markets had returned to their pre-recession performance levels.

Industry forecasts released by PKF Consulting anticipate that the average national occupancy will reach 65 percent by the end of 2015, the highest level achieved in the last 25 years. Since the depth of the depression reached in 2009, lodging demand has increased by nearly 26 percent while the supply of hotel rooms has increased by just 5.6 percent.

The continuing improvement in the economy, combined with the lack of new hotels, is expected to result in significant growth in revenues and profits through 2017. Average daily rates are forecast to increase by 5.7 percent annually over the next three years, while inflation is forecast at 2.5 percent.

Demand is forecasted to increase by 2.2 percent in 2015, while supply will increase by 1.3 percent, resulting in a 0.9 percent increase in occupancy. Occupancies in subsequent years are projected to stabilize as the rate of supply growth returns to historic levels.

Industry forecasts summarized in a report prepared by Robert W. Baird & Company¹ indicates that strong growth is expected to continue over the next two years. Lodging demand is expected to increase 2.6% - 3.1% in 2015 and 2.2% - 2.5% in 2016. Similarly, average daily room rates (ADR) are expected to increase between 5.5% and 6.2% this year, and between 5.0% and 6.1% next year. Revenue per available room (average rate times occupancy) is projected to increase between 6.4% to 7.6% percent this year and between 5.9% and 7.6% in 2015, declining slightly in 2016 to a range of 5.9% to 6.6%. This rate of growth is more than double the historic long run average.

Statewide hotel demand in Minnesota increased by 2.5 percent in 2014, according to STR Global data obtained from the Minnesota Lodging Association. Compared to demand growth of 4.4 percent in 2013, this indicates that the recovery has, for the most part, occurred so that future growth will be a result of real growth. For the first eight months of 2015, statewide demand has increased by 1.5 percent over the first half of 2014.

HOTEL DEMAND

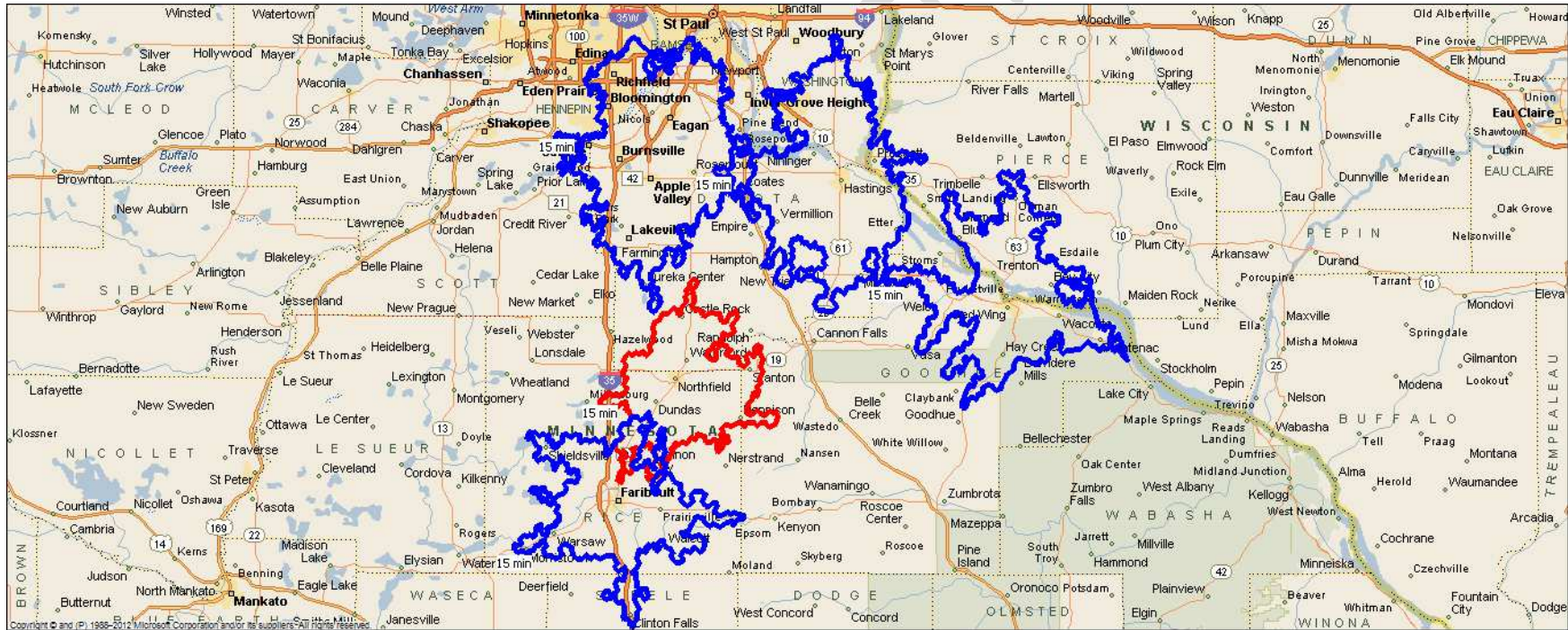
The size of Northfield's potential hotel market is limited by the proximity of the surrounding cities of Apple Valley, Faribault, Hastings, and Red Wing. The defined primary market area is shown in red on the following map, depicted by 10-minute drive zone.

The demand that would be available to a new hotel in Northfield consists of local commercial travelers, college-related visitors, group functions, and leisure demand. In order to quantify the amount of lodging demand that exists in the area, we interviewed hotel operators and representatives of area businesses, the two colleges, and local government. In addition, we evaluated the supply and room rates of competitive hotels in the surrounding area that were reported to accommodate Northfield lodging demand.

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

¹ *Hospitality Monthly – April 2015*, Robert W. Baird & Co., page 4.

Northfield Primary Market Area



Commercial Demand

Commercial demand occurs steadily throughout the year with little seasonal fluctuations other than a decline in business travel during holiday periods. This segment of demand occurs mostly during the weekdays. It originates from travelers conducting business in the area, attending meetings, and training sessions. Commercial travelers generally seek out franchised hotels that are located near their business destination. The availability of a conveniently located quality restaurant is often an important factor in hotel selection for this segment.

The amount of lodging demand from the commercial sector is limited in Northfield by its proximity to the Twin Cities. Many business visits originate from offices in Minneapolis or St. Paul and therefore do not require an overnight stay. Similarly, many out-of-town visitors prefer to stay near the airport, so return to the Twin Cities after their business has concluded.

We found that local companies generally do not have difficulty reserving hotel rooms during the work week, as capacity usually is available at the local hotels.

Some lodging demand is lost to the Holiday Inn & Suites in Lakeville and other hotels in Apple Valley. Reasons given for utilizing these hotels included higher quality, franchise reward points, no train noise, and proximity to restaurants.

Leisure Demand

The Leisure demand segment consists primarily of weddings and other social gatherings, visitors to local friends and relatives, hockey and other sport tournaments, and tourists visiting historic Northfield and local events. This market segment is largest during the summer months, when leisure travel and activity is at their peak, and reaches its low point in December and January. Leisure demand is typically the most price sensitive demand segment.

The Grand Event Center and the Northfield Ballroom both host weddings and other events that require hotel accommodations. Also, the Cannon Valley Winery is a popular wedding venue. A new hotel would be able to capture demand from functions held at these venues.

College Demand

College demand occurs throughout the year, with peaks in the late summer when students move-in and in the spring with graduation events. January is the slowest month for college demand as Carleton College is on break between semesters.

Certain activities held at both colleges overwhelm the local hotel supply. These include student orientation week for freshmen, homecoming/family week, reunion weekend, and commencement. The Christmas Festival held at St. Olaf also draws lodging demand. The colleges stagger their events to avoid overcrowding local resources as much as possible.

In addition to the scheduled events, the colleges generate large amounts of lodging demand from prospective student visits, visiting parents, conferences, workshops, and athletic contests.

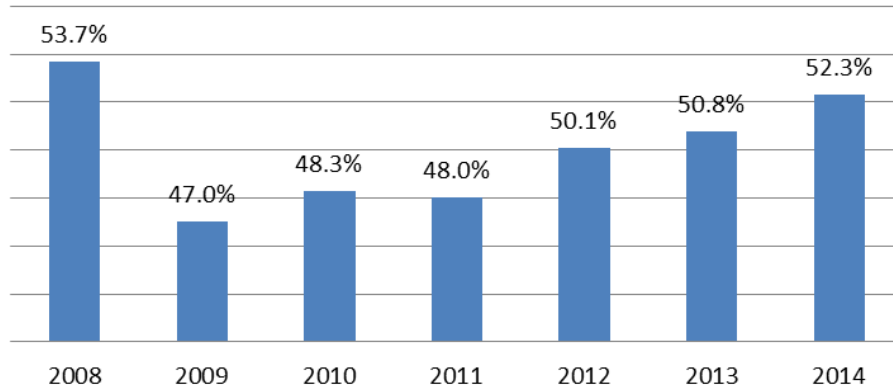
AREA HOTEL MARKET PERFORMANCE

In order to assess the recent hotel trends in the Northfield area market, we obtained detailed performance data for hotels in the Southern Minnesota sector from the Minnesota Lodging Association. The source of this data is STR Global, a well-known research firm that collects and provides lodging data to the industry. The Minnesota South region includes the area south of the Twin Cities but excludes Rochester and Mankato. Thus, the hotel data is derived from mostly smaller rural hotels. There are 92 hotels with a total of 5,726 rooms contributing to the region's data.

The amount of hotel demand accommodated in the region has steadily increased since the low point of the recession felt in 2009, and occupancy reached in 2014 was only 1.4 points below the 53.7 percent peak achieved in 2008. Demand in 2014 was 4.2 percent greater than the previous year and, for the first eight months of 2015, demand in this region is 4.4 percent above the same period last year.

The **occupancy** trend over recent years is shown in the following graph.

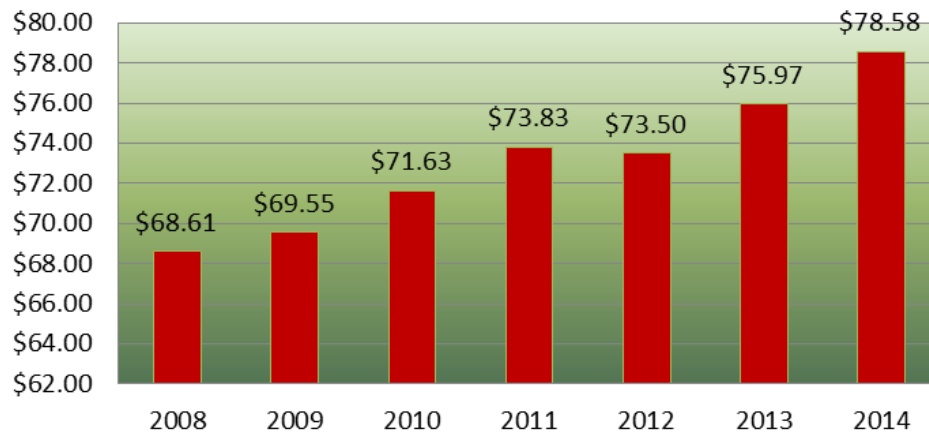
Occupancy Southern Minnesota Area



Source: STR Global

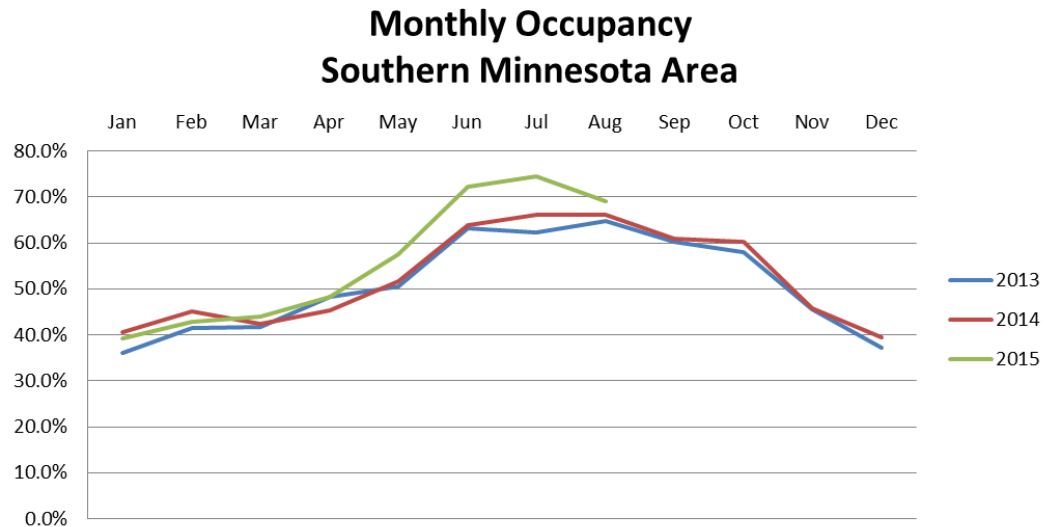
The region-wide **average daily rate** was not significantly impacted by the recession and has continued to increase every year. The compound annual average increase has been 2.3 percent since 2008. In 2014 the market's overall average rate was \$78.58. The ADR for the first eight months of 2015 is \$82.82, an increase of 4.4 percent over the same period last year. The recent trend in average daily rate is shown in the following graph.

Average Daily Rate Southern Minnesota Area



Source: STR Global

The **seasonality** of demand is an important component in projecting the annual occupancy a hotel can obtain. Monthly performance data for the southern region shows that lodging activity peaks in the summer and declines into the 40 percent range during the winter months.



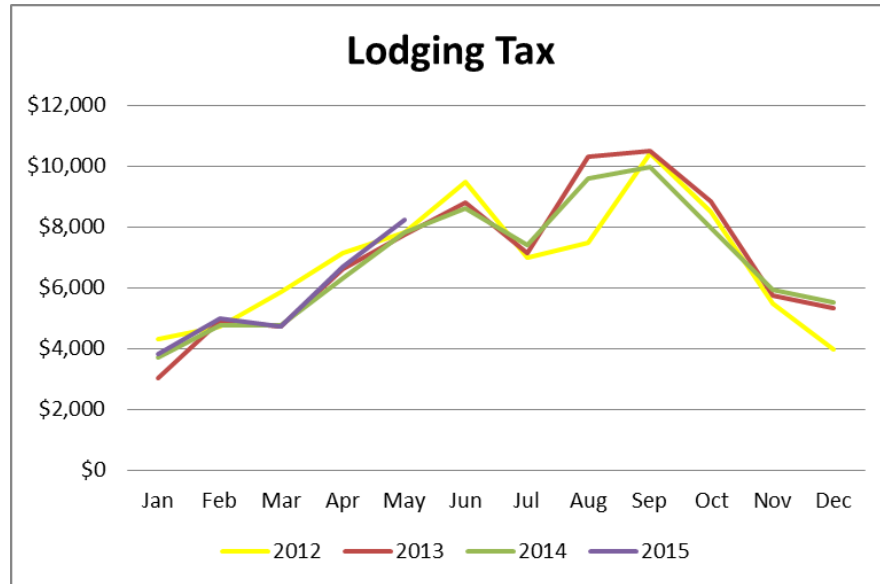
Source: STR Global

This data shows that the hotel supply in the Minnesota South region achieved an overall annual occupancy of 52 percent in 2014 and an average daily room rate of nearly \$79.

Northfield Lodging Tax

The City of Northfield collects a lodging tax equal to 3.0 percent of room sales. Room rentals that exceed 30 days are exempt from the tax, a factor that would apply to a portion of the lodging business at Americas Best Value Inn and to almost all of the College City Motel’s business.

Monthly lodging tax collections for the last three years and five months are graphed below. They demonstrate two important factors: the first factor is the seasonality of the local market which peaks in late May/early April and again in late August/early September; the second factor is that total transient room revenue has been relatively stable over the last three years. The peak demand periods are a result of student move-in/orientation during the fall and move-out/graduation activities in late May and early June.



Source: City of Northfield Finance Department

Lodging Demand

We have quantified the amount of lodging demand that is accommodated by the Northfield hotels based on interview with the hotel managers and analysis of lodging tax receipts. Similarly, we have estimated the amount of demand that a new hotel could capture from the overflow and other demand that is not being accommodated in the market at present.

We estimate that the Northfield hotels accommodated approximately 33,000 transient roomnights in 2014. The three competitive hotels were estimated to accommodate approximately 28,000 roomnights, achieving an annual combined occupancy of around 60 percent.

We estimate that the market experiences about 70 capacity nights a year, almost all of which occur on weekends. The high weekend demand has prompted the Archer House to require a 2-night minimum stay on most weekends and all of the competitive hotels charge a premium on weekends. Most of this demand is generated by functions held at the two colleges, as well, as visiting parents. Student arrivals in late May and early June fill the hotels to capacity, as does departures and graduation in late May and early June. Both colleges have alumni events, sponsor seminars, and host prospective student applicants. Athletic

contests also draw parents and alumni back to the campuses.

We also found that a substantial amount of commercial demand (estimated to be 1,700 roomnights) is leaving the market to find higher quality and/or quieter (no train noise) lodging accommodations.

The additional room capacity provided by a new hotel will allow the market to accommodate more demand on nights when college events and local events fill the available hotel rooms. By capturing this demand, as well as the commercial demand that leaves the market, we estimate that a new high quality franchised hotel could attract approximately 6,000 annual roomnights back to the Northfield market. This represents an increase of 21 percent in the demand currently being accommodated by the competitive supply.

**ESTIMATED NORTHFIELD COMPETITIVE DEMAND
2014**

Market Segment	Occupied Rooms	New Demand	Potential Demand	Market Mix
Commercial	12,200	1,700	13,900	41%
Leisure	6,300	2,100	8,400	25%
College	9,500	2,100	11,600	34%
Totals	28,000	5,900	33,900	100%

We estimate that approximately 41 percent of the lodging demand in the local market will be generated by commercial activity, 25 percent will come from leisure travelers, and 34 percent will be generated by the two colleges.

SECTION 6: RECOMMENDED FACILITIES

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

HOTEL FACILITY RECOMMENDATIONS

Building both quality and amenities into a hotel adds cost and therefore, higher quality hotels with a restaurant and meeting space must charge higher room rates. Thus, the price sensitivity of a market must be assessed in order to determine the type of a hotel project that can be supported by the subject market.

The full service hotel has all but disappeared in recent years for locations other than urban areas, large office parks, and corporate centers. This is due to their higher cost (and higher room rates) relative to limited service hotels who can offer the same quality room but at a lower rate. Due to the challenges of operating a restaurant, full service hotels are also considered to be of greater risk by lenders and investors.

Based on our evaluation of the local hotel supply and demand conditions we believe that a **limited service hotel of upper midscale quality with a strong franchise** is the lodging product that will perform best within the Northfield competitive market. We suggest that an all-suite hotel or a hotel with a significant number of suites be considered. Suites are particularly popular with leisure (and college) travelers and the Northfield market has a high percentage of this market segment.

It is important for the hotel to be constructed so as to minimize noise from the trains that pass within two blocks of the site. In addition to the active rail line that passes through the city, there is also a spur that extends up to Lakeville. Additional train traffic occurs as railcars are placed in storage or removed from storage in Lakeville.

Customer Loyalty

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

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

Guest Rooms

The guest rooms should include flat screen televisions with at least one premium movie channel, a coffee maker, and free high speed internet. A microwave and small refrigerator should also be provided in all or a majority of the rooms.

Meeting Room

The hotel should include a public function room of between 500 and 800 square feet. A room of this size could accommodate 50 to 70 for a meeting, 50 for a banquet, and 90 for a reception. This amenity will allow the hotel to attract additional lodging demand from area meetings and social functions.

The additional parking that would be required by functions needs to be considered when determining the size of the public function space.

Other Amenities

Other amenities that are recommended for the hotel include:

- An indoor pool that will improve the hotel's competitiveness for leisure travelers and visitors to area residents;

- An exercise room with several high quality exercise machines and a television;
- A business center with a computer and printer available to guests 24 hours a day;
- Complimentary hot breakfast for guests;
- High speed wireless internet access throughout the hotel; and
- Parking for 60 vehicles.

DRAFT

SECTION 7: SITE REVIEW

The hotel site identified by the Economic Development Authority is located along the Cannon River in the northwest quadrant of the intersection of Highway 3 and 2nd Street West. The location of this site is shown on the following map.



The site consists of 46,154 square feet or 1.06 acres. There is another adjacent small parcel of 5,000 to 6,000 square feet that may be able to be acquired as well. The site lies within a planned redevelopment area that has five undeveloped sites. Three of these parcels lie between the hotel site and the highway. The limited size of the site will require some type of structured parking if a 60-room hotel is developed.

ACCESS AND VISIBILITY

The site is easily accessed off of Highway 3 via a frontage road directly in front of the site. It is highly visible from both directions on the highway and from 2nd Street West.

The down town area is immediately across the river from the site, and Carleton College is within walking distance. Access to St. Olaf is conveniently provided by St Olaf Avenue two blocks to the north of the site. Most of the major companies are located along Highway 3 or are accessible from it.

SURROUNDINGS

A vacant parcel lies immediately to the north of the site and a newer midrise condominium project is adjacent to that parcel. A small two-story strip development is located between the vacant lot and Highway 3, which would not block the visibility of a midrise hotel. Across the highway are two fuel stations, a Holiday Station and an Amcon. On the next block are a Mexican restaurant and the Quarterback Club family restaurant. A variety of restaurants and pubs are within easy walking distance of the site.

CONCLUSION

Based on our review of the site, we consider it to be excellent for a hotel development. Its competitive advantages include proximity to the two colleges and to the down town area. It is also has good acces to the major employers and there are a variety of restaurants in the immediate area.

SECTION 8: UTILIZATION PROJECTIONS

Based upon an assessment of the market demand, we have estimated the potential utilization for a new hotel’s first five full years of operation, assumed to begin in 2017 and stabilize in 2019. In developing the utilization estimates, several key assumptions were made including the following:

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

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

PROJECTED OCCUPANCY

In order to calculate the occupancy that the subject hotel is likely to achieve, we looked at the performance of the other competitive hotels in the market

area and analyzed the lodging demand that is generated by employers, the two colleges, events, and activities in the Northfield area.

Lodging Demand Growth

In estimating future levels of lodging demand that could be captured by a new franchised hotel, we considered the following factors:

1. The continued recovery from the recession will result in more lodging demand. The hotel industry is tied directly to the regional and national economy. As business activity continues to pick up, salesmen, executives and other business travelers will return to the road in increasing numbers. As unemployed people find jobs, disposable income is increased, and household savings balances are restored, the amount of vacations and other leisure travel will increase. Hotel industry analysts expect the hotel industry to continue to improve through 2016, forecasting an annual compounded growth in revenue per available room (RevPAR) of around 6 percent for both years. To achieve this growth, demand is expected to increase at around 3 percent this year and 2 percent next year, and ADR is expected to increase between 5 and 6 percent in each year.
2. Northfield grew at an annual average compound rate of 1.5 percent between 2000 and 2010 and is expected to continue to grow in the future, although at a slower pace.
3. Population projections for Rice County show an expected 7.5 percent increase between 2010 and 2025. This represents a compound annual rate of 0.6 percent.
4. Lodging demand has increased in the Minnesota South region by 2.5 percent in 2013 and 4.2 percent in 2014. For the first eight months of 2015, demand in this region is 4.4 percent above the same period last year.
5. The new hotel would provide high quality facilities under a strong national franchise.

- 6. The addition of more hotel rooms will allow for more guests to be accommodated on the nights in which the hotels are at capacity, estimated to be 70 nights annually.

Based on these factors, we believe that an annual compound growth rate of **1.0** percent is a reasonable expectation for continued hotel demand growth of the lodging base in Northfield.

The projected market growth is summarized below.

**NORTHFIELD LODGING MARKET
Projected Growth (With 60-Room Hotel)**

Year	Available Competitive Rooms	Demand (Roomnights)	Growth Rate	Market Occupancy
2015 (1)	131	28,200	na	59%
Projected:				
2016	131	28,500	1.1%	60%
2017(2)	191	34,000	19.3%	49%
2018	191	34,600	1.8%	50%
2019	191	35,000	1.2%	50%
2020	191	35,200	0.6%	50%
2021	191	35,400	0.6%	51%

Note 1. Estimated

Note 2. Assumes subject hotel opens with 60 rooms

These projections show that the new hotel is expected to significantly increase the amount of demand that is accommodated in Northfield by capturing overflow and demand that currently leaves the market.

For projection purposes, we have assumed that the demand generated by the colleges will remain at present levels. This results in a lesser growth rate in the later years as only the base demand is projected to grow.

Projected Hotel Utilization

Based on the results of our market study, we estimate that a new hotel would be able to capture a premium above its fair share of the primary market demand. By calculating the ratio of the rooms available at the proposed hotel

to the total number of rooms available within the market, the “fair share” percentage of demand for the hotel may be determined. The fair share calculation reflects the market share that the hotel could expect to capture if all available rooms in the market were favored equally by potential guests and choices were made on a purely random basis. The recommended 60 rooms represents 31.4 percent of the competitive supply (60/191 = 31.41 %). Our analysis found that the hotel can expect to achieve a market share that has a 15 percent premium over its fair share of the base demand. When the recaptured commercial demand is added to the hotel’s business, its premium over fair share increases to 32 percent.

The results of our utilization analysis are presented in the following table, which show the subject hotel achieving projected occupancies that range from 58% in its first year to 64 percent in its fifth year.

**Northfield Hotel
Projected Market Mix and Occupancy
60 Rooms**

Market Segment	2017	2018	2019	2020	2021
Commercial	4,900	5,800	6,000	6,100	6,100
Leisure Travelers	3,300	3,300	3,400	3,400	3,500
College	4,400	4,400	4,400	4,400	4,400
Total Occupied Rooms	12,600	13,500	13,800	13,900	14,000
Available Rooms	21,900	21,900	21,900	21,900	21,900
Annual Occupancy	58%	62%	63%	63%	64%

Occupancies projected for the first two years are lower than the stabilized level of operation, as the hotel will require time to develop its marketing program, particularly for commercial business, and to maximize public awareness of the hotel. The hotel is expected to achieve its full market share of commercial demand in the third year, at which time its market penetration will stabilize.

Market Mix

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

**NORTHFIELD HOTEL
STABILIZED MARKET MIX**

Market Segment	2019	%
Commercial	6,000	43%
Leisure	3,400	25%
College	4,400	32%
Totals	13,800	100%

Analysis For A Larger Hotel

We have recommended a 60-room hotel based on the present market conditions. As is shown in the “Economic Feasibility” section presented later in this report, a hotel of this size is projected to provide very good financial returns within a relatively short period of time (three years).

However, there are circumstances that could justify the development of a larger hotel. Investors may have a longer term perspective that would encourage a larger hotel to take advantage of a strengthening market position. Over time, as the competitive hotels become increasingly obsolete, a larger hotel would allow it to take advantage of its growing competitive advantage. It may also delay the timing of a new competitor. Finally, a particular desirable hotel franchise may require a minimum size that is greater than 60 rooms.

In order to address this issue, we prepared utilization estimates for an 80-room hotel. The results of our utilization analysis are presented in the following table, which show the subject hotel achieving projected occupancies that range from 50% in its first year to 53 percent in its third and stabilized year.

Northfield Hotel
Projected Market Mix and Occupancy
80 Rooms

Market Segment	2017	2018	2019	2020	2021
Commercial	6,000	6,600	6,900	7,000	7,000
Leisure Travelers	3,700	3,800	3,800	3,800	3,900
College	4,900	4,900	4,900	4,900	4,900
Total Occupied Rooms	14,600	15,300	15,600	15,700	15,800
Available Rooms	29,200	29,200	29,200	29,200	29,200
Annual Occupancy	50%	52%	53%	54%	54%

PROJECTED AVERAGE RATE

The analysis from which we developed our projections of average daily rate for the proposed hotel included the quality and pricing structure of the other area hotels. As shown in the table below, current rates for regular rooms at the competitive area hotels are estimated to range from \$90 to \$153

The average daily rate at a hotel falls below its rack rates due to the numerous discounts that are offered to guests and large corporate clients, and to reduced rates charged during slack periods. The estimated average rates at these hotels range between \$100 and \$120.

COMPETITIVE AREA HOTELS

Hotel	Quality	2015 Rack Rates		Weekend Premium	Estimated 2015 ADR
		Regular	Suite		
Archer House	Midscale	\$90-\$130	\$180-\$200	\$20	\$118
Country Inn & Suites	Midscale	\$110	\$121-\$126	\$35-\$40	\$109
AmericInn	Midscale	\$100-\$105	\$130	\$20	\$100
Holiday Inn & Suites	Upper Midscale	\$135-\$153	\$171-\$190	\$10	\$120

Based on our analysis, we have determined that an upper midscale limited service hotel should be able to achieve an average rate of \$130 expressed in current dollars. Factored into the room rates projected for the subject hotel are an inflation factor of 2 percent and a real growth factor of 1 percent, for a total increase of 3 percent annually. The inflated average rate in 2017, the hotel's first full year of operation, is projected to be \$137.92.

NORTHFIELD HOTEL
Projected Average Daily Rate
60 Rooms

Year	Average Daily Rate
2015	\$130.00
2017	\$137.92
2018	\$142.05
2019	\$146.32
2020	\$150.71
2021	\$155.23

PROJECTED ROOM REVENUE

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

NORTHFIELD HOTEL
Projected Room Revenue
60 Rooms

	2017	2018	2019	2020	2021
Available Rooms	21,900	21,900	21,900	21,900	21,900
Occupied Rooms (Rounded)	12,600	13,500	13,800	13,900	14,000
Annual Occupancy	58%	62%	63%	63%	64%
Occupied Rooms (Rounded)	12,600	13,500	13,800	13,900	14,000
Average Daily Rate	\$137.92	\$142.05	\$146.32	\$150.71	\$155.23
Room Sales (Rounded)	\$1,738,000	\$1,918,000	\$2,019,000	\$2,095,000	\$2,173,000

SECTION 9: FINANCIAL PROJECTIONS

Estimates of cash flow from operations before debt service have been prepared for the first five years of operation for the hotel, with 2017 assumed to be the first full year of operation. The major assumptions as to the hotel occupancy and room rates are noted at the bottom of the projection columns and have been developed from an analysis of the local lodging market. The operating expense projections are derived from comparable hotels and industry data for small limited service hotels.

Room revenues reflect an annual increase of 3.0 percent in average daily rate and expense categories have been inflated at an annual rate of 2.0 percent. Many of the expenses were projected on an amount per occupied room basis, while the relatively fixed expenses reflect only inflationary increases. The projected rooms expense, maintenance and utility expense have both a fixed and a variable component.

The financial projections on the following page are presented in the format suggested by the Uniform System of Accounts for Hotels.

NOTES TO FINANCIAL PROJECTIONS

Revenue

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

Food & Beverage Revenue consists of the sale of soda, snacks and microwavable food.

Other Operated Departments consists of telephone commissions, meeting room rentals, movie rentals, guest laundry, and pool rentals,

60-ROOM HOTEL - NORTHFIELD, MN						
PROJECTED CASH FLOW FROM OPERATIONS						
BEFORE DEBT SERVICE						
	<u>2017</u>		<u>2018</u>		<u>2019</u>	
	AMOUNT	%	AMOUNT	%	AMOUNT	%
REVENUE:						
Rooms	\$1,737,754	98.4%	\$1,917,736	98.5%	\$2,019,163	98.5%
Food & Beverage	5,081	0.3%	5,444	0.3%	5,565	0.3%
Other Operated Departments	22,597	1.3%	24,696	1.3%	25,749	1.3%
Total Revenue	1,765,433	100%	1,947,876	100%	2,050,477	100%
DEPARTMENTAL EXPENSES						
Rooms Departmental Expenses	419,274	24.1%	458,125	23.9%	478,911	23.7%
Food & Beverage	10,162	200.0%	10,888	200.0%	11,130	200.0%
Other Operated Departments	22,597	100.0%	24,696	100.0%	25,749	100.0%
Total Departmental Expenses	452,033	25.6%	493,709	25.3%	515,790	25.2%
Total Departmental Profit	1,313,400	74.4%	1,454,167	74.7%	1,534,687	74.8%
UNDISTRIBUTED OPERATING EXPENSES						
Administrative & General Expenses	165,750	9.4%	175,980	9.0%	182,491	8.9%
Marketing Expenses	90,642	5.1%	95,819	4.9%	98,879	4.8%
Franchise Fee (Royalty)	112,954	6.4%	124,653	6.4%	131,246	6.4%
Utility Costs	68,822	3.9%	73,960	3.8%	76,696	3.7%
Property Operations & Maintenance	83,570	4.7%	89,808	4.6%	93,131	4.5%
Total Undistributed Operating Expenses	521,738	29.6%	560,219	28.8%	582,443	28.4%
GROSS OPERATING PROFIT	791,661	44.8%	893,947	45.9%	952,244	46.4%
Management Fee	70,617	4.0%	77,915	4.0%	82,019	4.0%
INCOME BEFORE FIXED CHARGES	721,044	40.8%	816,032	41.9%	870,225	42.4%
FIXED CHARGES:						
Property Taxes	38,203	2.2%	77,935	4.0%	79,494	3.9%
Insurance	21,649	1.2%	22,082	1.1%	22,523	1.1%
Replacement Reserve	17,378	1.0%	38,355	2.0%	60,575	3.0%
Total Fixed Charges	77,230	4.4%	138,371	7.1%	162,592	7.9%
CASH FLOW AVAIL. FOR DEBT SERVICE	\$643,814	36.5%	\$677,661	34.8%	\$707,633	34.5%
OCCUPANCY	58%		62%		63%	
ADR	\$137.92		\$142.05		\$146.32	
OCCUPIED ROOMNIGHTS	12,600		13,500		13,800	
<i>The comments and assumptions contained in the report are an integral part of these financial projections.</i>						

60-ROOM HOTEL - NORTHFIELD, MN				
PROJECTED CASH FLOW FROM OPERATIONS				
BEFORE DEBT SERVICE				
	<u>2020</u>		<u>2021</u>	
	AMOUNT	%	AMOUNT	%
REVENUE:				
Rooms	\$2,094,808	98.5%	\$2,173,175	98.5%
Food & Beverage	5,605	0.3%	5,646	0.3%
Other Operated Departments	26,455	1.2%	27,178	1.2%
Total Revenue	2,126,868	100%	2,205,999	100%
DEPARTMENTAL EXPENSES				
Rooms Departmental Expenses	493,750	23.6%	509,038	23.4%
Food & Beverage	11,211	200.0%	11,291	200.0%
Other Operated Departments	26,455	100.0%	27,178	100.0%
Total Departmental Expenses	531,416	25.0%	547,507	24.8%
Total Departmental Profit	1,595,453	75.0%	1,658,491	75.2%
UNDISTRIBUTED OPERATING EXPENSES				
Administrative & General Expenses	187,803	8.8%	193,279	8.8%
Marketing Expenses	101,246	4.8%	103,667	4.7%
Franchise Fee (Royalty)	136,163	6.4%	141,256	6.4%
Utility Costs	78,655	3.7%	80,661	3.7%
Property Operations & Maintenance	95,510	4.5%	97,946	4.4%
Total Undistributed Operating Expenses	599,377	28.2%	616,810	28.0%
GROSS OPERATING PROFIT	996,076	46.8%	1,041,681	47.2%
Management Fee	85,075	4.0%	88,240	4.0%
INCOME BEFORE FIXED CHARGES	911,001	42.8%	953,441	43.2%
FIXED CHARGES:				
Property Taxes	81,084	3.8%	82,705	3.7%
Insurance	22,974	1.1%	23,433	1.1%
Replacement Reserve	83,792	3.9%	86,927	3.9%
Total Fixed Charges	187,850	8.8%	193,066	8.8%
CASH FLOW AVAIL. FOR DEBT SERVICE	\$723,151	34.0%	\$760,376	34.5%
OCCUPANCY	63%		64%	
ADR	\$150.71		\$155.23	
OCCUPIED ROOMNIGHTS	13,900		14,000	
<i>The comments and assumptions contained in the report are an integral part of these financial projections.</i>				

Departmental Expenses

Rooms Departmental Expenses include payroll and related benefit expenses for the front desk and housekeeping. It also includes other miscellaneous rooms expenses such as breakfast expense, cleaning and guest room supplies, cable TV fees, linens and cleaning supplies, and other direct operating costs for the rooms department. The cost of providing telephone service is included in this category as well. The payroll component of this expense is relatively fixed, varying only slightly in response to changes in occupancy, as housekeeping staff and certain other hourly workers have variable schedules.

Food & Beverage Departmental Expenses include payroll and related expenses associated with providing guest breakfasts, along with the raw costs for food and beverages served and the cost of supplies.

Other Operated Departments comprise those expenses (labor and other) which offset the revenue generated by other operated departments such as concessions, guest laundry, a rental activity.

Undistributed Operating Expenses

Administrative and General Expenses include management and administrative payroll and the general costs associated with operating the hotel facility, including credit card commissions, bank charges, professional fees, travel and entertainment and other miscellaneous costs.

Marketing Expenses include the costs associated with advertising, sales and promotion, and include travel agent commissions, promotional materials, guest loyalty program costs, and other promotional expenditures. This expense was calculated to range from 5.1 percent to 4.7 percent of total revenue over the projection period

Franchise Fees are fees paid to the franchise company as a royalty. The expense is calculated to be 6.5 percent of room revenue, an amount typical for large franchises.

Utility Costs expense includes costs related to heating and cooling, electricity, gas, water and sewer. Utilities expense is projected from a base of \$5.25 per occupied room and includes both a fixed and a variable portion.

Property Operations & Maintenance expenses includes the costs associated with repairs, maintenance, grounds keeping, and other related property operating costs. This expense is reduced in the early years as the facility will be new and the equipment under warranty.

Management Fee

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

Fixed Charges

Property tax expense is projected from an estimate of \$1,200 per room, an amount derived from industry data. This expense amounts to approximately 3.8 percent of total revenue. In the first year, the tax expense assumes the hotel is only half completed at the time of assessment.

Insurance expense is projected to be \$340 per room, similar to the premiums paid by other hotels with pools.

Replacement Reserve represents funds that will be set aside from operating cash flow to fund the future cost of replacing and upgrading furnishings and fixtures in the facility that will be required to maintain its competitive standing in the market on a continuing basis. This reserve is calculated at 2.0 percent of projected total revenue in the second year, increasing to 4.0 percent in the third and subsequent years.

ECONOMIC FEASIBILITY ANALYSIS

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

Project Cost

The following development budget estimate was prepared by Hospitality Consulting Group for purposes of testing the economic feasibility of the project. It is based on budgets from other hotel projects on which we have

worked. However, the quality and scope of amenities selected for the actual project and the need for a parking structure, could cause the costs to vary significantly.

For analysis purposes, we have assumed the hotel to have a total cost of \$7,500,000, or approximately \$125,000 per guest room.

60 Room Hotel Northfield, Minnesota

60 guest rooms and suites, indoor pool, meeting room, exercise room

	Cost	Per Room
Land	\$360,000	\$6,000
Utilities, Grading, Paving, Landscaping	240,000	4,000
Building Construction	4,800,000	80,000
Fixtures, Furnishings, and Equipment	900,000	15,000
Indirect Costs	1,200,000	20,000
Total	\$7,500,000	\$125,000

Financing Scenario

For analysis purposes we have assumed an equity investment of \$1,875,000 (25 percent of total project cost), leaving a loan of \$5,625,000 to provide funds for the \$7,500,000 total project cost.

Source of Funds:		
Equity	\$1,875,000	25%
Debt	5,625,000	75%
	\$5,750,000	100%

Debt Term Assumptions:

Annual Interest Rate:	5.0 %
Amortization:	20 years
Annual Payment:	\$445,470

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

60 Room Hotel- Northfield, MN
Economic Feasibility Analysis
Estimated Project Cost: \$7,500,000

	2017	2018	2019	2020	2021
Cash Flow Available for Debt Service	\$643,814	\$677,661	\$707,633	\$723,151	\$760,376
Debt Service	\$445,470	\$445,470	\$445,470	\$445,470	\$445,470
Debt Service Coverage	1.4X	1.5X	1.6X	1.6X	1.7X
Cash Flow to equity	\$198,344	\$232,191	\$262,163	\$277,681	\$314,905
Equity	\$1,875,000	\$1,875,000	\$1,875,000	\$1,875,000	\$1,875,000
Return on Equity	10.6%	12.4%	14.0%	14.8%	16.8%

A debt coverage ratio (cash flow/annual debt service) of a minimum of 1.2 times is required and 1.4 times is typically preferred by lenders. This analysis shows that the hotel is projected to generate sufficient cash flow to meet its debt service requirements. Also, in this simple analysis, the projected cash on cash return on equity equals or exceeds 14 percent once the hotel reaches its stabilized level of operation.

Hotel investors typically like to see cash on cash returns of at least 10 percent, although local investors may accept a slightly lower return in order to bring a new hotel to the community. Also, a hotel development company, who also would manage the hotel, may include the management fee in its investment decision.

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

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

ADDENDUM

DRAFT

CONSULTANT QUALIFICATIONS HOSPITALITY CONSULTING GROUP

Stephen Sherf – President, Hospitality Consulting Group

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

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

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

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

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

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

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