ISSI HSSI Sustainability Solutions

White Paper

"Sustainability – A KEY TO HIDDEN PROFITS"

Prepared for the Hospitality Industry Speaking Circuit

November, 2014

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Hotel Sustainability Solutions, Inc. (HSSI)

"Sustainability is an Integral Component of Value Creation"

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Sustainability
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SUSTAINABILITY – *"A KEY TO HIDDEN PROFITS"*

Ownerships and Asset Managers may be ***overlooking*** short term added asset value by **not** employing sustainability platforms to their assets. Often, added asset value occurs over a period of time when upward trending occupancy, ADR and Rev Par adjustments are realized. The time line may take 2-5 years and only so in an up trending market place.
The application of a sustainability platform can add asset value and reduce operating costs, much sooner, than market rate adjustments and compounds the economic benefits to owned assets.

The ***capitalization*** of reduced operating costs has the potential of adding significant value to the assets individually or collectively in individual properties or portfolios. The merger of these two strategies can compound the added asset values generated.

Today, a number of the active purchasing groups in the hospitality market place are including a sustainability review in the due-diligence process to identify more immediate added asset value potential upon closing. Identifying opportunities to reduce costs via sustainability and other cost reductions contemplated from due diligence potentially offset significant costs associated with PIP requirements.

Brand standard up grades can have significant economic impacts on the asset purchase returns on investment. Sustainability applications can enhance and accelerate projected ROI. Building sustainability platforms into a PIP program can have a significant impact on PIP budgets via rebates, incentives at the local, state and federal levels. Cost offsets via incentives enable budget elasticity while preparing to reduce operating costs at the startup of facility operations. Sufficient cost reductions which add asset value can be beneficial to financing strategies. Lenders today are becoming increasing attentive to properties demonstrating sustainability practices via technologies, systems and products. Their interest is heightened because of their awareness of present governmental mandates and those coming to all markets. An example is the significant amended California Title 24 requirements which became effective July 1, 2014. The new measures contained within the new Title 24 standards, if history repeats itself, will become evident in other markets, as California often has a reputation for trend setting. The Federal Government is actively pursuing Climate Change Initiatives and state and local jurisdictional agencies are reacting with swift responses.

There are other pressures impacting the California market place but signs are appearing in a number of nationwide markets. Hospitality depends on having dependable supplies of electricity, gas and water to meet all operational requirements. Two of these utilities electric and water are of immediate concern in seven western states and already state wide reduction mandates are imposed. A continuum of the draught conditions will change from requested usage reduction requirements to mandated reductions. Additionally, current demands on electricity providers for renewable components to their service areas are resulting in significant cost adjustments. Especially in demand charges which have risen 30% in the San Francisco region and water charges are increasing rapidly throughout the state, especially in privately owned water districts. Facilities with chillers where blow downs are required in operations will soon see unprecedented rising sewer costs along with both domestic and gray water rate increases. Irrigation programs of heavily landscaped areas may require major design changes to meet their imposed restrictions.

There are substantial changes taking place, demanding energy-efficiency and water conservation action plans as a significant component of local, state and federal Climate Control Action Plans. Hospitality must find solutions to meet its demands to protect positive guest experiences by reducing current quantities to stay under the future reduction mandates. It can be done through well planned sustainability integration and collaboration strategies. The challenge to take action is NOW!

Fortunately, the rapid advancement of technologies, products and systems enables the development of sustainability platforms that address the issues of cost reductions and usage reductions. Significant areas needing attention are both usage and generation costs reductions especially in the area of electricity. The demand charge escalations sited above will continue their cost escalations especially in the Southern California Edison service areas where the recent closure of the San Onofre Nuclear Power Plant has created a significant impact on supply. Already, a line item is appearing on utility bills to help offset the closing and rebates ($400/ton) are now available to customers to take steps to initiate energy-efficiency strategies to reduce demand in offsetting their lost supply.

This is happening in other areas of the country as pressure is applied to fossil fuel power generation facilities.

There are a number of sustainability strategies worthy of consideration in developing solution strategies for hospitality.

Power Generation sources can have significant cost reduction results through fuel cell, micro-turbine, and wind power within the hospitality sector. For example, integrating a micro-turbine with a wind turbine and the use of storage batteries has the ability to closely achieve a **net Zero** building (onsite generation matching onsite usage). All technologies qualify as energy-efficient and available for a range of incentives and financing programs to offset CAPEX concerns. Savings are significant (potentially $300,000) and are capable of servicing applicable debt with positive cash flow to ownership. Generation options curb employee bad habits. For example, the storage batteries have incentives for about 60% of the $100,000 cost with the balance covered from PACE.

Usage Reductions will achieve operating reductions in numerous areas of the facilities by employing LED Lighting (inside and outside), motion sensors, HVAC energy control systems, diming systems, automated on/off switching, food digesters, automated fan control systems, appliance change outs to Energy Star rated units utilizing rebates, elevator upgrades, motor change outs, window film and review of HVAC Systems for operational efficiencies. **(Partial list)** The Hilton Concord (client) has **34 sustainability initiatives** implemented and consideration of **6** additional items for Phase 2 could achieve a **net zero facility.** In achieving NET Zero it will require fine-tuned practices from engineering, not exercised to date. Getting to a net zero building will allow us to make application to PG&E to reclassify the property to a lower rate structure which would be a substantial savings itself.

Additional economic benefits are available to be considered in the development of a sustainability platform.

EPAct 179D is a Federal Energy Tax Deduction IRS program providing tax deductions for all commercial buildings & parking garages (hospitality included) exhibiting energy-efficiency which is calculated allowing up to $1.80 per square foot. The provision provides $0.60/sq. ft. for impacting building perimeter, $0.60/sq. ft. for lighting and $0.60/sq. ft. for HVAC. While EPAct 179D sunsetted on 12/31/2013, it has been passed by both houses appropriation committees to reinstate it. Approval is anticipated in late 2014. However, a provision permits properties whose activity occurred after 2006 but before 12/31/2013 to retain their eligibility. In Hilton Concord (client) the maximum amount is **$686,476** ($1.80 x 381,376 sq. ft.) and eligibility would be determined via the required energy audit. A five (5) year carry forward applies.

Cost Segregation is an especially beneficial tax benefit to a newly renovated property. It is a process of identifying personal property assets and/or tenant improvement costs that may be grouped with real property assets and separating their costs for tax reporting purposes. Adjustments in the depreciation schedules are utilized. In the Hilton Concord (client) an initial review was prepared on the guest rooms only, and an indication was that **$3.4M** was available and has a Five (5) year carry forward. Adding the common areas etc. it is projected to be in the **$4.5 - $5M + range**.

IRS Codes 1245/1250 (depreciation and abandonment of replaced fixtures) can have significant impacts on ROI calculations for lighting retrofits. Again, such deductions are available for Hilton Concord (client). **Approximately $275-325,000 +.**

Total potential available tax deductions for ownership $5,232,651 - $6,011,476.00 and an additional $250-300,000 operating cost reductions derived from the combination of employing available generation and usage technologies.

Financing Facilities have become available to offset **CAPEX** constraints that have delayed or eliminated implementing sustainability strategies and the loss of operating cost reductions and added asset values. Both conventional and tailored programs are available which are identified as off balance sheet financing tools. Utility companies, vendors, local government subsides can offer alternatives.

PACE (Property Assessed Clean Energy) is the most recent entry and now has been approved by 31 states and is quickly being adopted by counties and cities as a vehicle to accelerate energy-efficiency and water conservation measures in properties. The City of Los Angeles through LABBC (LA Better Building Challenge) has organized 42M square feet of commercial (including hospitality) properties to achieve energy-efficiency and water conservation measures and is backed by the DOE (20% energy reduction) and will use PACE funding through the LADWP. HSSI has been approved as a provider of sustainability services to the LABBC program through a partnership it formed. PACE was adopted by the City of Concord on July 22, 2014. A commitment permitting funding of all of Phase one (1) sustainability initiatives and consulting fees, engineering studies; along with all Phase Two (2) proposed initiatives (fan controls, elevator upgrades, power generation (wind turbine, micro-turbine, storage batteries) and water sensor system for irrigation conservation have been pre-approved for utilization with PACE. PACE uses the tax assessed value of the property as its financing platform and all payments are made at the same time of property tax payments. Terms run 5-10-15-20 years based on the life cycles of the items financed. Warranties determine term, in most cases; items can be bundled in like term arrangements. Interest rates have ranged from 4.25- 6.45% fixed. All rebates and incentives flow to benefit of ownership. They can be applied to reduce loan amounts or retained for deposits or used to cover most other sustainability initiatives costs. Major lenders such as BOA, Wells Fargo, and insurance companies have given their required consent, since it has same priority as property taxes. The reasons for granting approvals have been, it increases value and reduces operating costs improving their debt/equity positions. Upon sale of the property, PACE travels with the property to the new ownership along with the continued savings. (No prepayment penalty or payoff required) Experience is indicating that it requires only 40-50% of the savings to service the PACE debt with the balance flowing to ownership establishing a **cash flow positive** project immediately. PACE providers who have **on demand** financing available, can fund in 45-90 days or less. All costs are rolled up in the financing package.

The above have been identified to offer suggestions for ownership to capitalize on the assortment of tools available to finance sustainability platforms **without CAPEX** constraints and reduce operating costs while adding asset value to individual properties and/or portfolios.

The alignment of advanced technologies, systems and products with financing facilities, rebates and incentives, compliance with mandated regulations presents a compelling case for moving forward to protect bottom line erosion from profits and asset values due to significant projected utility cost escalations.

Utilizing the tax savings ***makes sound business sense*** in that why would any profit driven enterprise choose to pay taxes to the federal or state agencies, when those sustainability derived tax savings could be applied towards assets, reducing operating costs and adding asset value across a property or portfolio realizing significant economic value.

Note: It needs to be acknowledged that there is a wide range of utility rate structures, rebate programs, union and non-union contracts, financing options and market differentials that impact project results; however, investigative analysis can quickly ascertain such impacts and identify the solid opportunities.

Example: A project having a commercial office portfolio of 38M sq. ft. is expecting to reduce operating costs by $14-16M, add $220M of asset value by using all the above sustainability tools to achieve their goals. They intend using PACE to fund significant **CAPEX** projects, rather than wait for projected schedules and thus take advantage of the operating savings while holding the assets; until, they are sold and capture the added asset value in their sales prices or in taking the portfolio public. The added value is expected to provide them with beneficial alternatives for future financing.

AGAIN, let it be stated **"Sustainability** - ***Is A Key to Hidden Profits"*** whether you own existing assets or are purchasing assets, the hidden profits are waiting to be uncovered.

HSSI was recipient with Client Hilton Concord , Concord, California of the prestige's 2013 GEELA AWARD presented by the Governor and State of California for Sustainability Leadership in Economic and Environmental Partnership. This is the highest honor granted by the State of California and the Governor's office recognizing exemplary Sustainability Leadership. The project was recognized for its unique approach of integration and collaboration strategies.

This White Paper has been prepared by Charles A. Smith, CEO of Hotel Sustainability Solutions, Inc. (HSSI) providing Sustainability Analysis, Design & Implementation (turnkey) of sustainability platforms for hospitality ownerships of Resort, Full Service and Limited Service hotel properties/portfolios.

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