

June 21, 2013



Mr. Robert Mills
Norwich Community Development Corporation
77 Main St.
Norwich, CT 06360

RE: NORWICH HOTEL – INCENTIVE PACKAGE STRUCTURE

Dear Bob and Kevin:

Thank you again for your recent efforts on our project. I'm pleased to pass along the news that Jim Frey, from our office, had a very positive meeting with the Norwich Fire Marshall yesterday. We greatly appreciate the Fire Marshall's willingness to help Winston mitigate potential project roadblocks, such as this sprinkler issue. As a result, we've finalized the hotel's cost budget with our GC.

That said, at this juncture, Winston needs a clear and definitive understanding from you both ***that you will and do support***—in an urgent manner, as time is of the essence—CT Norwich's request for City and State commitments 'to implement' what we now believe will be an ***urban renewal area designation and redevelopment plan*** for the subject property.

You have been clear in your assertion that a tax fixing agreement in excess of seven years is not possible. You have also been clear that adoption of the Cities and Towns act will require a public referendum and is thus a highly uncertain outcome.

You recently advised us that our most likely viable alternative is to consider an incentive program combination including: a 12-65b tax fixing agreement, SBA 504 financing, Small Business Express Loan and Grants, and other notable programs. We have thoroughly investigated this option.

Please bear in mind that Winston's fundamental concern for this project is abating the risk of additional capital losses, not locking in profits.

With that said, as I will explain in great detail below, our investigation into the SBA program definitively concluded that an SBA capital structure is not an adequate solution for us. For starters, availability of SBA construction financing appears to share the same level of certainty as does Norwich's adoption of the Cities and Towns act. Yesterday, Mr. Gary Toole at the CTCIC highlighted, 'the high volume of hospitality defaults in Connecticut have made it very difficult to secure construction financing for any hotel development projects.' Mr. Toole's commentary confirmed there is currently limited appetite to provide hotel construction loans; securing construction loan funds is, in and of itself, a time consuming and uncertain endeavor. I encourage you to call Mr. Toole directly at 203.776.6172 (ext 124) to confirm.

On risk. Although pursuing outsized project returns through increased leverage is often popular, leverage clearly adds interest costs as well as an increased principal repayment requirement to the project. As Winston's cost basis in this project increases, you will see the dramatic downside risk that accompanies even minor project under-performance¹. I belabor the point, of Winston's potential downside risk, to further support why our requested incentives are absolutely critical: Winston is willing to accept a below-market rate of return and still move forward on the project, but Winston has a responsibility—to its hundreds of employees—to allocate capital responsibly in order to sustain jobs.

¹ Winston received three independently produced market studies for the hotel between 2011 and 2013; each subsequent study demonstrated decreased average daily rate ("ADR") and occupancy projections. As a result, Winston believes future decreases in revenue metrics are possible at the very least. Our analysis intends to highlight the effects of such a decrease.

On numerous occasions Kevin has said he will not support our pursuing a TIF-type structure unless he is absolutely certain the property has no potential of going forward under any other structure. Unfortunately, that’s exactly where the circumstances are.

More On our SBA 504 program findings. First, positively, I confirmed your assertion that the SBA’s estimated coupon rate is, in fact, the effective interest rate inclusive of fees. Unfortunately, Mr. Toole confirmed: (i) the SBA program does not provide credit enhancements during construction that might entice a senior lender to provide excess leverage necessary to advance an initial \$8.5mm in construction proceeds; (ii) the SBA loan proceeds and coupon rates are not committed to until after certificates of occupancy are issued, which means the SBA will not mitigate interest rate risk for our permanent loan request; and (iii) 5 or 10 year permanent financing will not be co-terminus with the SBA’s 20-year term, thus refinancing risk is not mitigated through this program.

While Winston can secure 50% loan-to-cost construction financing through our existing lender relationships, our lender does not permit mezzanine financing (e.g., the contemplated SBA debt). Moreover, for the SBA capital structure, repayment guarantees are required during the life of that loan. In contrast, our banking relationships allow for these guarantees to go away over time. Finally the permanent loan refinancing, in our model, requires no guarantees.

Why TIF proceeds are necessary. Please note I’ve enclosed two tables below, from Winston’s cash flow analyses: (1) Winston’s baseline capitalization request with 50% construction leverage and our requested incentives and (2) the ‘SBA capitalization’ assumes 71% leverage (or ~\$8.5mm in loan proceeds) under the SBA capitalization structure and excludes our requested TIF incentives. Under Winston’s baseline capital structure, we anticipate generating an approximate 9.5%, leveraged, project level IRR if the hotel performs as expected. A 9.5% leveraged yield is a substantially below market-rate of return for hotel projects. Winston will accept this well below-market yield and still move forward. However, again, what makes our requested capital structure absolutely necessary is that our request mitigates Winston’s downside losses –relative to the SBA capitalization structure- if the project underperforms.

In the following tables, note negative numbers are highlighted in red and Winston’s underwritten projections are highlighted in yellow:

Table 1A, below, reflects 50% leverage including incentives (e.g., Winston’s capitalization)

Table 1 - WHI Levered IRR - Year 1 ADR versus Annual ADR Inflation									
		<u>ADR Inflation Rate</u>							
		9.48%	0.00%	0.500%	1.000%	1.500%	2.000%	2.500%	3.000%
<u>Year 1 ADR</u>	\$110.00	-9.34%	-6.68%	-4.22%	-1.92%	0.24%	2.29%	4.24%	
	\$113.33	-7.20%	-4.47%	-1.96%	0.44%	2.60%	4.65%	6.59%	
	\$116.67	-4.71%	-2.00%	0.50%	2.82%	4.99%	7.05%	9.00%	
	\$120.00	-2.15%	0.53%	3.00%	5.30%	7.45%	9.48%	11.42%	
	\$123.33	0.38%	3.07%	5.54%	7.83%	9.97%	11.94%	13.77%	
	\$126.67	3.10%	5.73%	8.09%	10.25%	12.24%	14.10%	15.84%	

Table 1B, below, reflects 71% leverage excluding TIF incentives (e.g., SBA capitalization)

Table 1 - WHI Levered IRR - Year 1 ADR versus Annual ADR Inflation									
		<u>ADR Inflation Rate</u>							
		3.71%	0.00%	0.500%	1.000%	1.500%	2.000%	2.500%	3.000%
<u>Year 1 ADR</u>	\$110.00	-28.71%	-22.51%	-17.49%	-13.21%	-9.44%	-6.05%	-2.95%	
	\$113.33	-26.84%	-20.06%	-15.32%	-10.68%	-6.69%	-3.14%	0.06%	
	\$116.67	-26.00%	-17.98%	-12.12%	-7.39%	-3.35%	0.20%	3.36%	
	\$120.00	-22.84%	-14.45%	-8.52%	-4.02%	0.11%	3.71%	6.93%	
	\$123.33	-18.77%	-10.99%	-4.84%	-0.04%	3.98%	7.49%	10.71%	
	\$126.67	-14.93%	-6.24%	-0.42%	4.11%	8.06%	11.49%	14.57%	

As you can see Winston’s risk of loss is greatly exacerbated through the use of outsized leverage in conjunction with the higher cost basis accompanying the SBA capitalization. Assume, for instance, that our hotel’s Year 1 ADR is \$116.67 and each year thereafter that rate grows by only 1.0%. Under Winston’s requested capital structure our return on invested capital will be **negative 1.96%**. However, under the SBA capitalization our return for those same assumptions will be **negative 12.12%**. Because we assume that leverage and cost basis will have no impact on cash flows or terminal value, leverage and an increased cost basis dramatically increases our risk of loss on this project.

Moreover, increased leverage fixes the amount of capital owed while property value varies according to revenue and cash flow. As a result, if ADR does not grow from the projected \$120 ADR, under Winston’s capital structure, our net loss (in today’s, non-discounted, dollars) will be (\$403,000). However, under the SBA capital structure Winston’s loss will be approximately \$2mm.

Table 2A, below, reflects 50% leverage including TIF incentives

Table 2 - WHI Levered Net Profit - ADR Inflation Rate versus Terminal Cap Rate									
		Terminal Cap Rate							
		\$2,240,125	9.0%	9.5%	10.0%	10.5%	11.0%	11.5%	12.0%
ADR Inflation Rate	0.000%	\$446,218	(\$834)	(\$403,181)	(\$767,209)	(\$1,098,143)	(\$1,400,301)	(\$1,677,278)	
	0.500%	\$1,003,720	\$531,184	\$105,901	(\$278,878)	(\$628,677)	(\$948,060)	(\$1,240,826)	
	1.000%	\$1,571,846	\$1,073,313	\$624,634	\$218,686	(\$150,357)	(\$487,310)	(\$796,184)	
	1.500%	\$2,150,749	\$1,625,700	\$1,153,156	\$725,616	\$336,943	(\$17,932)	(\$343,234)	
	2.000%	\$2,740,582	\$2,188,489	\$1,691,606	\$1,242,044	\$833,352	\$460,198	\$118,141	
	2.500%	\$3,341,502	\$2,761,830	\$2,240,125	\$1,768,106	\$1,338,997	\$947,203	\$588,058	
	3.000%	\$3,953,666	\$3,345,870	\$2,798,855	\$2,303,935	\$1,854,009	\$1,443,207	\$1,066,638	
Sale Value/Rm		\$99,456	\$94,222	\$89,511	\$85,248	\$81,373	\$77,835	\$74,592	

Table 2B, reflects 71% leverage and excludes TIF incentives.

Table 2 - WHI Levered Net Profit - ADR Inflation Rate versus Terminal Cap Rate									
		Terminal Cap Rate							
		\$563,699	9.0%	9.5%	10.0%	10.5%	11.0%	11.5%	12.0%
ADR Inflation Rate	0.000%	(\$1,212,440)	(\$1,659,492)	(\$2,061,839)	(\$2,425,867)	(\$2,756,801)	(\$3,058,959)	(\$3,335,937)	
	0.500%	(\$654,938)	(\$1,127,474)	(\$1,552,757)	(\$1,937,536)	(\$2,287,336)	(\$2,606,718)	(\$2,899,485)	
	1.000%	(\$86,812)	(\$585,345)	(\$1,034,024)	(\$1,439,972)	(\$1,809,015)	(\$2,145,968)	(\$2,454,842)	
	1.500%	\$474,323	(\$50,726)	(\$523,270)	(\$950,810)	(\$1,339,482)	(\$1,694,357)	(\$2,019,659)	
	2.000%	\$1,064,156	\$512,063	\$15,180	(\$434,382)	(\$843,074)	(\$1,216,227)	(\$1,558,285)	
	2.500%	\$1,665,076	\$1,085,404	\$563,699	\$91,680	(\$337,429)	(\$729,223)	(\$1,088,368)	
	3.000%	\$2,277,240	\$1,669,445	\$1,122,429	\$627,510	\$177,583	(\$233,219)	(\$609,788)	
Sale Value/Rm		\$99,456	\$94,222	\$89,511	\$85,248	\$81,373	\$77,835	\$74,592	

Simply through visual interpretation, Tables 1 and 2 demonstrate the increased volatility accompanying the SBA capital structure. Please also recall that property tax collections have absolute priority over the collateral in any foreclosure action. Conversely, in the even the hotel underperforms pro-forma assumptions, and Winston, as the borrower, finds itself in default on our obligations, we will be the first to lose our invested capital. As a result, Winston’s equity bears the most risk of underperformance while the City of Norwich’s tax collections will benefit from absolute priority.

What Winston is willing to do. Finally, please note that in accepting a 9.5% leveraged project return in exchange for allocating additional capital to this project, Winston will be charging-off, as “sunk costs”, an amount necessary to make this project equivalent to a more market-competitive 12.09% unlevered and 19.74% levered yield. This charge-off will be approximately 72% of capital expenditures (or “sunk costs”) to date.

Under Winston’s requested capital structure, we will be “sharing in the pain” Norwich incurs from granting our incentive requests. To enforce this point, I have never in my career charged-off 72% of my capital investment in a project and still moved forward on that project. Winston views going forward on this project as a loss. Our concern, at this point, however, is to minimize –and not exacerbate– potential losses in the future.

As a show of good faith, Winston is happy to propose structures where the hotel pays excess property taxes, above and beyond its baseline, in the event the property achieves certain performance milestones. Doing so can prevent any “windfall” profit to Winston.

You need to know that our requested capital structure is **the only** way to get this project completed and to generate incremental revenues for the City. Once it is built, we will be committed to the property’s continuous upkeep. As hoteliers, we are highly conscientious of our product’s reputation and quality. To attract interstate travel and leisure guests, we continuously reinvest in our properties in order to maintain the highest possible standards. For these reasons, we are confident that once built, Winston will persevere with our business plan despite market volatility.

To help communicate our message, I am available to speak about this project and the contents of this letter at any time. At your direction, I will gladly make myself available to any government officials, government chambers, businesses, or citizen groups that you think might need to better understand our request.

Again, what Winston needs from you, Bob and Kevin, is a confirmation of your support in our requested capital structure for this project. If you are definitively unwilling or unable to support us in this endeavor, please advise us accordingly so that we can take appropriate action. As always, we appreciate your timely responsiveness.

Kind regards,



Bob Winston
Chief Executive Officer
Winston Hospitality, Inc.