<u>Technical Details of Recommendation to Enter the Short-Term Rental Market</u>

I recommend that Watershed…[*should enter the short-term rental market with 16 properties initially, all located in Miami and Austin. Based upon results of this initial entry, in Year 2, Watershed can expand to the other cities included in my analysis. The Watershed Property IDs of those 16 properties are (ranked in order of profitability):*
- *W156*
- *W155*
- *W164*
- *W163*
- *W107*
- *W120*
- *W108*
- *W152*
- *W110*
- *W160*
- *W114*
- *W112*
- *W119*
- *W111*
- *W116*
- *W157*

]

The analysis that serves as the basis of my recommendation indicates that Watershed and its client would benefit from $___[*826,715*]___ of increased profits during the first year, and yearly profits of $___[*730,715*]___ every year thereafter if my recommendation is enacted. The initial capital investment needed to implement my recommendation would be $___[*480,000*]___. This analysis is based on financial assumptions that were confirmed by company and industry experts, but sensitivity analyses indicate that Watershed should enter the short-term rental market with their client, even if these initial assumptions need to be revised. Below, I describe the analyses I used to arrive at my conclusion, and report the results of my sensitivity analysis that assesses how expected profits and needed capital expenditure would change if my assumptions are modified.

<u>Analysis Summary</u>

I modeled the relationship between nightly rental price and occupancy rate for short-term rental properties using data from current short-term rentals managed by other companies and owners. I used this model to predict the short-term rental price that would maximize profits from each of Watershed's client's properties if it were managed as a short-term rental property. The metrics I report are based on the sum of the forecasted profits that would be gained and the forecasted capital investment that would be needed if my recommendation is followed, after the following are taken into account: (1) initial furnishing costs, (2) upkeep costs, (3) internet service fees, (4) regulatory fees, (5) hospitality charges (including key service and cleaning), (6) typical duration of stay, and (7) utilities. The details of the assumptions I used are provided below (Table 1), followed by a description of the results of my sensitivity analysis.

Analysis Assumptions and Sensitivity Analysis Ranges

Table 1

Consideration	Assumed Value	Source of Original Assumed Value	Minimum Value Tested [Entry Set 5]	Maximum Value Tested [Entry Set 6]	Rationale for Range of Values Tested [Entry Set 7]
Additional profit needed for a property to be considered "more profitable as a short-term rental"	$6,000	Watershed Financial Department	3,000	12,000	50% initial estimate, 200% initial estimate
Cost to convert property to short-term rental (includes furnishing and decorating)	$30,000	Watershed Marketing Department	15,000	60,000	50% initial estimate, 200% initial estimate
Years to depreciate capital expenditures	5	Watershed Financial Department	3	10	Realistic extreme expectations of wear-and-tear
Yearly upkeep	$6,000	Watershed Marketing Department	3,000	12,000	50% initial estimate, 200% initial estimate
Service fees to short-term stay website (e.g. Airbnb)	20%	Watershed Marketing Department	10%	30%	+/- 50% initial estimate
Regulatory fees (taxes and potential legal fees)	10%	Watershed Financial Department	5%	15%	+/- 50% initial estimate
Hospitality charges (key service, cleaning, re-stocking)	$100	Watershed Financial Department	50	200	50% initial estimate, 200% initial estimate
Typical stay duration (days)	3	Watershed Marketing Department	1	7	Minimum possible stay up to one full week
Monthly utilities per property	$300	Watershed Financial Department	200	400	+/- $100

As agreed upon at the beginning of the project, some issues were NOT incorporated into the analysis, but could be incorporated in the future to help optimize short-term rental rates or to further refine projected profits (Table 2):

Table 2

Factor not included in analysis	Reason for exclusion from analysis
Weekly or seasonal changes in rental prices/occupancy rates	Instructions from Project Manager
Promotions, coupons, or special events	Instructions from Project Manager
Loss in rental income while property is converted	Instructions from Project Manager
Differences in utility rates across properties	Instructions from Watershed Financial Department

I have created a dashboard that illustrates the effects of changing these assumptions on predicted profits and required capital investment that is available to anybody on the team by request. **The minimum**

additional profits Watershed could earn when the assumptions were modified within the ranges described above was $___[*59,000*]___, if all the properties that are "more profitable" as a short-term rental are converted. **The maximum additional profits Watershed could earn when the assumptions were modified within the ranges described above was $___[*4,301,000*]___**, if all the properties that are "more profitable" as a short-term rental are converted. The modified set of parameters associated with this minimum and maximum value are provided below (Table 3). Overall, the parameter that affected profits most was _____[*Regulatory and service fees*]_____.

Table 3

Consideration	Value in Assumption Set that led to Minimum Profits [*Entry Set 11*]	Value in Assumption Set that led to Maximum Profits [*Entry Set 12*]
Additional profit needed for a property to be considered "more profitable as a short-term rental"	12,000	3,000
Cost to convert property to short-term rental (includes furnishing and decorating)	60,000	15,000
Years to depreciate capital expenditures	3	10
Yearly upkeep	12,000	3,000
Service fees to short-term stay website (e.g. Airbnb)	30%	10%
Regulatory fees (taxes and potential legal fees)	15%	5%
Hospitality charges (key service, cleaning, re-stocking)	200	50
Typical stay duration (days)	1	7
Monthly utilities	400	200

Predictive Modeling Details

I was provided with four types of information about short-term rentals of the same type (number of bedrooms, apartment or house, kitchen availability, unshared property) and in the same location as Watershed's client's 244 properties: a typical short-term nightly rental rate, the corresponding occupancy rate for the property with that rental rate, the 10th percentile nightly rental rate, and the 90th percentile nightly rental rate. When the typical rental prices were expressed in terms of percentiles relative to

Linear Regression Line:
y = -0.79x + 0.85
R² = 0.52
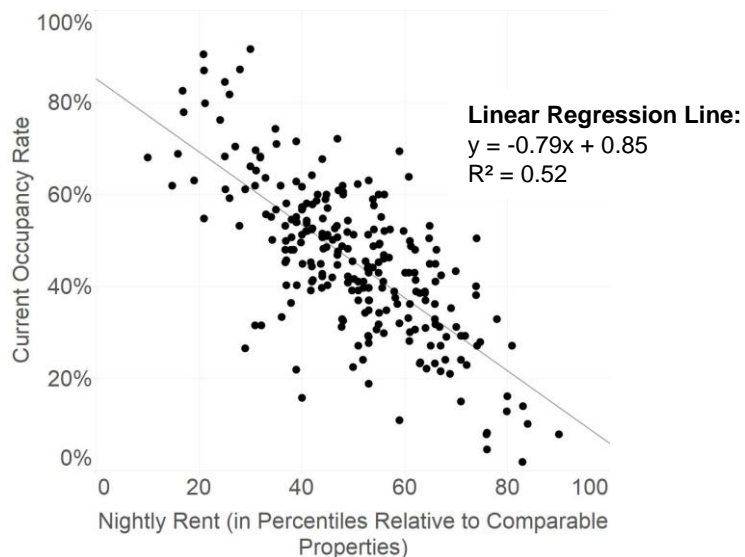
properties of the same type and in the same location—but not when they were analyzed as raw dollar values—they correlated linearly with occupancy rates:

I used the parameters of the regression line and Excel's Solver optimization function to find the rental price and occupancy rate that would maximize the profits expected from each of Watershed's client's 244 properties. Any optimized price below the 10th percentile rate was replaced with the 10th percentile rate, and any optimized price above the 90th percentile rate was replaced with the 90th percentile rate, in order to account for lack of data outside of these ranges in the linear model. These optimized rental rates were entered into a financial cash flow and profit model that computed the expected revenue from each property based on its projected occupancy rate, and the expected costs according to the financial assumptions described above.